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89-196

NO. _____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

RAILROAD COMMISSION OF TEXAS,
Petitioner

V.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

Appendix To Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

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VOLUME 1

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96pp

TABLE OF CONTENTS OF APPENDIX

EXHIBIT A

PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

WALKER OPERATING CORPORATION, et al., *Petitioners*

v.

FEDERAL ENERGY REGULATORY COMMISSION, *Respomdent*

Nos. 85-2683, 85-2698, 86-1195, 86-1196, 86-1197, 86-1198, 86-1199, 86-1200, 86-1201, 86-1204, 86-1206, 86-1207, 86-1208

PHILLIPS PETROLEUM COMPANY; NORTHERN STATES POWER COMPANIES; LAKE SUPERIOR DISTRICT POWER COMPANY; NATURAL GAS PIPELINE COMPANY OF AMERICA; IOWA PUBLIC SERVICE COMPANY; ANADARKO PRODUCTION COMPANY; PAN EASTERN EXPLORATION COMPANY; INTER-CITY GAS; THE ENERGY ISSUES INTERVENTION OFFICE OF THE MINNESOTA DEPARTMENT OF PUBLIC SERVICE; NORTHERN NATURAL GAS COMPANY, DIVISION OF ENRON CORP.; COLORADO INTERSTATE GAS COMPANY; DORCHESTER MASTER LIMITED PARTNERSHIP; MOBIL PRODUCING TEXAS & NEW MEXICO INC.; WILLIAMS NATURAL GAS COMPANY; TEXACO PRODUCING INC.; CONOCO, INC.,

Intervenors.

Jerry D. Courtney, of Lowe & Courtney, of Clarendon, Texas, for Stowers Oil & Gas Company, and Walker Operating Corporation; Robert J. Kapelke, of Gorsuch, Kirgis, Campbell, Walker & Grover, of Denver, Colorado, with him on the briefs for Walker Operating Corporation; and Miles O'Laughlin, of Pampa, Texas, of counsel, with him on the briefs for Stowers Oil & Gas Company.

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John H. Conway (Catherine C. Cook, General Counsel, and Jerome M. Feit, Solicitor, with him on the brief), Attorney, for the Federal Energy Regulatory Commission.

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John L. Williford and Jennifer A. Cates, of Bartlesville, Oklahoma, for Phillips Petroleum Company.

P. M. Schenkkan, of Vinson & Elkins, of Austin, Texas, for Anadarko Petroleum Corporation and Pan Eastern Exploration Company.

Paul E. Goldstein, Jerome Mrowca, and Barbara A. Gustafson, of Lombard, Illinois, for Natural Gas Pipeline Company of America.

Patrick J. McCarthy, of Adams and McCarthy, of Omaha, Nebraska; Frank J. Duffy, Vice President and General Counsel, and Jane G. Alseth, of Northern Natural Gas Company, Division of Enron Corp., of Omaha, Nebraska; and George J. Meiburger and Steve Stojic, of Gallagher, Boland, Meiburger and Brosnan, of Washington, D.C., for Northern Natural Gas Company, Division of Enron Corp.

Gene R. Sommers, of Northern States Power Company, of Minneapolis, Minnesota, for Northern States Power Companies.

Christopher K. Sandberg, of Attorney General's Office, State of Minnesota, St. Paul, Minnesota, for the Energy Issues Intervention Office of the Minnesota Department of Public Service.

Charles H. Shoneman, of Bracewell & Patterson, of Washington, D.C., and David Lindberg, of Houston, Texas, for Texaco Producing Inc.

Before LOGAN, and TACHA, Circuit Judges, and A. ANDERSON, District Judge.*

TACHA, Circuit Judge.

* Honorable Aldon J. Anderson, Senior United States District Judge for the District of Utah, sitting by designation.

This case presents for review, pursuant to 15 U.S.C. § 717r(b) and 15 U.S.C. § 3416(a)(4), two orders issued by the Federal Energy Regulatory Commission (FERC). These administrative orders determined that certain oil well operators had violated federal law by the diversion of natural gas dedicated to interstate commerce and by selling that gas at a price in excess of the statutorily established maximum price. We hold that FERC had jurisdiction to issue those orders, that FERC's findings of fact were based upon substantial evidence, that its conclusions of law were reasonable, and that there are no procedural grounds for overturning the orders. We affirm.

I.

The Texas Panhandle is the site of a vast hydrocarbon reservoir, the overlying surface area of which is some 124 miles long and averages approximately twenty miles in width. This reservoir contains both oil-producing and gas-producing formations, with the most significant formation for natural gas production being the brown dolomite. Often, a gas producing horizon overlies an oil producing horizon. Furthermore, when a formation produces both gas and oil, the hydrocarbons constituting oil, being denser than those constituting gas, usually will be found in the lower portions of that formation. Within a specific well, the contact line between the gas zone and the oil zone is referred to as the "gas-oil contact."

Within this area, generally referred to as the Panhandle Field, the spacing of oil wells and of gas wells must comply with state regulations that establish specific oil well and gas well proration units. A proration unit here is "[t]he area in a pool that can be efficiently and economically drained by one well, as determined by [the agency regulating production]." H.

Williams & C. Meyers, *Oil and Gas Terms* 777 (7th ed. 1987); *see* 15 U.S.C. § 3301(8). The Railroad Commission of Texas has designated oil fields by county within the Panhandle Field area and has established ten- or twenty-acre oil proration units for the oil wells in these fields. Likewise, the Railroad Commission has divided the Panhandle Field area into two gas fields, establishing 640-acre gas proration units in the Panhandle West Gas Field and 160-acre gas proration units in the Panhandle East Gas Field. Within the Panhandle Field, the gas rights and the oil rights to the same surface area often are separate leasehold estates held by separate parties. Thus, at times, separate and multiple leasehold estates may apply to the various hydrocarbons produced from a single well bore. *See Dorchester Gas Producing Co. v. Harlow Corp.*, 743 S.W.2d 243, 250-51 (Tex. Ct. App. 1987, no writ).

Because a gas proration unit and an oil proration unit can occupy the same surface area, and because of the "split lease" situation, in the Panhandle Field area it is possible ---and quite often--- the case that the proration units for several oil wells might overlap a single gas well's proration unit, with the oil wells being operated by a different operating company from that operating the gas well. As the Fifth Circuit recently noted, "[w]ith the advent of new drilling and legal strategies, the so-called 'split leases' have now for several years produced a steady flow of gas, controversy, and litigation." *Pan E. Exploration Co. v. Hufo Oils*, 855 F.2d 1106, 1109 (5th Cir. 1988).

From its early days the geological and regulatory realities of the Panhandle Field have led periodically to friction between oil producers and gas producers, especially over problems arising from the perforation of oil well casings in a gas-producing horizon above the oil-producing horizon in which the well was completed.

The gas producers saw this activity, sometimes called "high perforation," as resulting in production of natural gas to which they held proper title.

In the Panhandle Field area, production of oil usually will result in some natural gas also being produced from the oil well. This, in fact, occurs in the area that is the subject of these proceedings, because there the "free gas phase overlies and is in contact with a black oil zone." *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,031 (1985) (recommended decision). At a minimum, this type of gas ---from an oil-producing horizon --- and inevitably produced along with the oil from that horizon is known as "casinghead gas." The parties here dispute what else is included in that term.

The statutory and regulatory structure of Texas oil and gas law recognizes the possibility of gas and oil production from the same well. Texas statutes therefore classify specific producing wells as "oil wells" or as "gas wells" based on a specific well's "gas-oil ratio."[1]

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[1]The gas-oil ratio is "[t]he number of cubic feet of gas produced per barrel of oil produced." H. Williams & C. Meyers, *Oil and Gas Terms* 398 (7th ed. 1987).

The Texas statutory definition of gas well provides that:

"Gas well" means a well that:

(A) produces gas not associated or blended with oil at the time of production;

(B) produces more than 100,000 cubic feet of gas to each barrel of oil from the same producing horizon; or

(C) produces gas from a formation or producing horizon productive of gas only encountered in a well bore through which oil also is produced through the inside of another string of casing.

Tex. Nat. Res.Code Ann. § 86.002(5) (Vernon 1978). The statutory definition of oil well provides that: "'Oil well' means any well that produces one barrel or more of oil to each 100,000 cubic feet of gas." *Id.* § 86.002(6).

In 1983 the FERC enforcement staff began a preliminary investigation into natural gas sales by oil operators in the Panhandle West Gas Field. The investigation focused on the activities of thirty-seven oil well operators whose oil wells and oil proration units were located on the same surface acreage (the subject acreage) as the gas wells and gas proration units of Dorchester Gas Producing Company (Dorchester). In February 1984 FERC issued an order requiring the thirty-seven oil well operators to show cause why they should not be found to have violated section 7(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717f(b), by the diversion of natural gas dedicated to interstate commerce, and section 504(a)(l) of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3414(a)(l), by selling that gas at a price in excess of the statutorily established maximum price. *Stowers Oil & Gas Co.*, 26 FERC ¶ 61,207, 61,478-80 (1984) (show cause order).

A hearing was conducted, and in January 1985 the administrative law judge (ALJ) issued a recommended decision that found thirty-five of the oil well operators in violation of one or both of the statutory provisions. *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017 at 65,048-49 (1985) (recommended decision). The ALJ found that the evidence against the two remaining operators was inconclusive and required further investigation. *Id.* at 65,049.

In determining whether the operators had sold natural gas at a price in excess of its statutory ceiling price, the ALJ first had to determine whether that gas was being produced from reserves that Dorchester had dedicated to interstate commerce. Any gas produced from a Dorchester gas proration unit is dedicated gas. Although the operators' oil proration units and the Dorchester gas proration units sometimes occupy overlapping surface areas, the ALJ concluded that the

Texas regulatory scheme used each well's gas-oil contact to divide the overlying gas proration units from the underlying oil proration units. Therefore, if the operators had produced gas from above the gas-oil contact, they would have been diverting natural gas dedicated to interstate commerce, and, consequently, they would have been selling gas at a higher ceiling price than that allowed by law.

The operators claimed that it was ultimately irrelevant whether gas from their wells had been produced from dedicated reserves. They pointed to pricing category determinations made by Texas for most of their wells. Those determinations, they asserted, removed all gas produced by those wells from the statutory ceiling price for dedicated gas. The ALJ concluded, however, that those well determinations covered only the *casinghead* gas produced by the operators and that, as a practical matter, the Texas definition of casinghead gas covered only that gas produced from below the gas-oil contacts. Therefore, if the operators were producing gas from above the gas-oil contact, they were, in fact, diverting dedicated gas and selling it at a price above its statutory ceiling price.

In July 1985 FERC affirmed the ALJ'S recommended decision "in its entirety, including all findings of fact and conclusions of law." *Stowers Oil & Gas Co.*, 32 FERC ¶ 61,043, at 61,136 (1985) (opinion no. 239). After FERC issued a subsequent order denying motions for stay and requests for rehearing, *Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207 (1985), the thirty-five operators appealed to this court for review of the Commission's orders. Before this court, the petitioners are those operators together with third parties who have also petitioned for review. Other third parties are present as intervenors, some in support of the petitioners and some in support of the respondent, FERC.

II.

This case requires us to examine the appropriate demarcation of authority between federal and state regulatory agencies. Much of the petitioners' argument on appeal is devoted to the contention that FERC impinged impermissibly upon areas reserved for state regulation and, therefore, attacks the agency's jurisdiction below. Congress, moreover, has directed the reviewing courts to "hold unlawful and set aside agency action . . . found to be . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right." 5 U.S.C. § 706(2)(C). Therefore, before turning to specific judicial review of FERC's findings of fact, its conclusions of law, or its decision, we address this threshold issue of FERC's jurisdiction.

A.

Congress has established a regulatory scheme that allocates specific areas of natural gas regulation to state or to federal regulators. We first examine, therefore, the contours of that regulatory scheme.

Prior to congressional action, the Supreme Court held that the "mere force of the commerce clause of the Constitution" barred state agencies from interfering with interstate sales of natural gas. *Missouri ex rel. Barrett v. Kansas Natural Gas Co.*, 265 U.S. 298, 307-08 (1924). In 1938 Congress stepped into the area by enacting the NGA, ch. 556, 52 Stat. 821 (1938) (codified as amended at 15 U.S.C. §§ 717-717w). "[W]ithout supplanting any of the existing authority of the state agencies, the Act was intended to provide a powerful regulatory partner, the Federal Power Commission, which could regulate activities where the state bodies could not." *Corporation Comm'n v. Federal Power Comm'n,* 415 U.S. 961, 962 (1974) (Rehnquist, J.,

dissenting from summary affirmation).[2] The NGA delineated specific areas as areas of federal regulation or of state regulation. For example, the transportation or sale of natural gas for resale in interstate commerce was affirmatively placed within the federal regulatory sphere, while intrastate commerce in natural gas, and such matters as production or local distribution, were relegated to the state regulatory sphere.[3] Perhaps the most noteworthy area reserved for state regulation was the "production or gathering of natural gas," 15 U.S.C. § 717(b).

Although Congress delineated areas of federal and of state regulation, inevitably conflicts developed between the two regulatory spheres. Such conflicts, however, are subject to the principle that the jurisdiction of the states is contingent upon state regulation not intruding into those areas clearly within the sphere of federal regulation. In *Northern Natural Gas Co. v. State Corp. Comm'n,* 372 U.S. 84 (1963), the

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[2]The NGA named the Federal Power Commission as the federal agency responsible for the enforcement of the Act. *See* 15 U.S.C. §§ 717a(9), 7171-717o, 717s. In 1977 FERC assumed those enforcement responsibilities. *See* 42 U.S.C. §§ 7172(a), 7341.

[3]Section l(b) of the NGA establishes the state and federal regulatory areas. That section states:

> (b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.
>
> 15 U.S.C. § 717(b).

Supreme Court addressed a state's defense of its regulation on the basis of the production or gathering exemption and noted that "it has been consistently held that 'production' and 'gathering' are terms narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution," *id.* at 90. Furthermore, the Court declared:

> it was settled even before the passage of the Natural Gas Act, that direct regulation of the prices of wholesales of natural gas in interstate commerce is beyond the constitutional power of the States -- whether or not framed to achieve ends, such as conservation, ordinarily within the ambit of state power.

Id. at 90 (emphasis in original). Finally, the Court held that, after the enactment of the NGA, "[t]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas or for state regulations which would *indirectly* achieve the same result." Id. at 91 (citation omitted) (emphasis added).[4] The jurisdiction of FERC

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[4]Then-Justice Rehnquist's dissent from summary affirmation, in *Corporation Comm'n v. Federal Power Comm'n*, 415 U.S. 961 (1974), provides a decidedly forceful comment on the practical decline of the states' power under the NGA. The comment is also a poetic one. Noting that "the state regulatory agencies were among [the NGA's] strongest supporters," *id.* at 962 (Rehnquist, J., dissenting), Rehnquist recalls the following limerick:

> "There was a young lady from Niger
> Who smiled as she rode on a tiger.
> They returned from the ride
> With the lady inside,
> And the smile on the face of the tiger."

(footnote continued on next page)

"was not intended to vary from state to state, depending upon the degree of state regulation and of state opposition to federal control." *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 681 (1954).

Not only must state regulatory action give way if it, directly or indirectly, intrudes into the comprehensive federal regulatory scheme, but it is also true that state regulation under the production or gathering exemption does not bar legitimate federal regulatory action that Congress clearly delegated to FERC. *In Colorado Interstate Gas Co. v. Federal Power Comm'n*, 324 U.S. 581 (1945), the Supreme Court considered an appeal of a federal order fixing new rates for gas transported by two natural gas companies. The Court, addressing the argument that the federal order was barred by the production or gathering exemption, held that the exemption did not preclude the federal agency "from reflecting the production and gathering facilities of a natural gas company in the rate base . . . for the purposes of determining the reasonableness of rates subject to its jurisdiction." Id. at 603. Thus, even though "[t]hat treatment of producing properties and gathering facilities has of course an indirect effect on them," the production and gathering clause did not shield those properties or facilities from the consequences of the proper federal regulatory action. *Id.*

Over its first forty years, the NGA regulatory structure -- with prices in the interstate market controlled by federal regulation and prices in the intrastate markets largely left to market forces -- began to create problems. "[S]hortages in the interstate

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(footnote continued from previous page)
Id. at 961 (Rehnquist, J., dissenting). Justice Rehnquist then states that, given recent case law concerning the NGA, "the state regulatory agencies must surely feel a special kinship with the young lady from Niger." *Id.* at 962 (Rehnquist, J., dissenting).

market developed because gas producers could get higher prices in unregulated intrastate markets." *FERC v. Martin Exploration Management Co.*, 108 S. Ct. 1765, 1767 (1988). In response to this situation, in 1978 Congress enacted the NGPA, Pub. L. No. 95-621, 92 Stat. 3351 (1978) (codified as amended at 15 U.S.C. §§ 3301-3432).[5]

> The statutory scheme established by the NGPA divides natural gas production into numerous categories that are distinguished by the date that production began from a well or the particular type of drilling involved. Gas in these categories can be broadly classified as "old" gas, "new" gas, or difficult to produce gas. "Old" gas is generally that produced from wells that had been operating before the passage of the NGPA. . . ."New" gas is generally that produced from wells that began production after the passage of the NGPA. . . .Several methods of production are specifically described in the statute as difficult to produce gas. . . . The categories are not mutually exclusive: a particular sale may be "dually qualified" within a "new" or "old" gas category and also a difficult to produce category.
>
> The NGPA established ceiling prices for each of these categories of natural gas production.

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[5]The NGPA named FERC as the federal agency responsible for the enforcement of the Act. *See* 15 U.S.C. §§ 3301(24), 3411, 3414(b).

Martin Exploration Management Co. v. FERC, 813 F.2d 1059, 1063-64(10th Cir. 1987) (citations omitted) (footnotes omitted), *rev'd on other grounds*, 108 S. Ct. 1765 (1988).

With the enactment of the NGPA, some doubt arose whether Congress had "altered those characteristics of the federal regulatory scheme which provided the basis in *Northern Natural* for a finding of pre-emption." *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 474 U.S. 409, 417 (1986). The Supreme Court soon dispelled that doubt and held that Congress' shifting of some specific pricing regulation away from FERC and into the control of market forces had not removed that regulation from the "comprehensive federal regulatory scheme." *Id.* at 422. Consequently, Congress had not "intended to give the States the power it had denied FERC." Id. (reversing judgment of Mississippi Supreme Court that NGPA had vitiated *Northern Natural Gas*). Also, because the NGPA's natural gas categories spanned both interstate and intrastate gas, "the NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first time." *Id.* at 421.

In sum, the Supreme Court has narrowly interpreted the exceptions to FERC's jurisdiction over the regulation of natural gas. With this in mind, we turn to FERC's actions in this case to determine whether they impermissibly impinged upon regulatory activities expressly reserved for the state.

B.

"The standard of review on a jurisdictional decision of the FERC is whether the decision was without an adequate basis in law." *Alexander v. FERC*, 609 F.2d 543, 546 (D.C. Cir. 1979), *quoted in National*

Ass'n of Regulatory Utility Comm'rs v. FERC, 823 F.2d 1377, 1382 (10th Cir. 1987). A recent Tenth Circuit decision upheld FERC's determination that it had jurisdiction over whether certain gas was dedicated to interstate commerce. *National Ass'n of Regulatory Utility Comm'rs*, 823 F.2d 1377. In making that decision, this court looked to the statutory language, its interpretation by the Supreme Court, and policy considerations in holding that FERC's interpretation of the congressional intent was reasonable. *Id.* at 1383, 1385.

The petitioners here mount an attack against the statutory jurisdiction of FERC. They contend generally that the production or gathering clause bars FERC from hearing any issues involving such matters as gas-oil ratios, gas-oil contacts, casinghead gas, or high perforations. More specifically, they contend that in this case the integral nature of these "production" issues barred FERC from inquiring into either the scope of Dorchester's natural gas reserves dedicated to interstate commerce or the scope of the Texas pricing determinations covering the petitioners' wells. We disagree.

The Commission here was regulating the price ceilings of sales of natural gas in interstate commerce. As the Supreme Court has noted, "sales in interstate commerce for resale by producers to interstate pipeline companies do not come within the 'production or gathering' exemption." *Phillips Petroleum*, 347 U.S. at 680-81 (stating what *Phillips Petroleum* Court saw as the "ground" of the decision in *Interstate Natural Gas Co. v. Federal Power Comm'n*, 331 U.S. 682 (1947)).

In order to ascertain whether the petitioners had diverted gas dedicated to interstate commerce, FERC had to determine the natural gas reserves that were subject to Dorchester's certificate of public convenience

and necessity. Section 7 of the NGA requires a natural gas company to obtain from the Commission "a certificate of public convenience and necessity" prior to engaging in the sale or transportation of natural gas in interstate commerce for resale. 15 U.S.C. § 717f(c), (e).[6] Moreover, once a natural gas company has obtained a certificate of public convenience and necessity, that gas is "dedicated" to interstate commerce, and that producer cannot abandon its supplying of natural gas into interstate commerce, unless the Commission grants it permission to do so, *see United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 536, 542 (1979); 15 U.S.C. § 717f(b),[7] or unless that gas falls within the provisions of section 601(a)(1)(B) of the NGPA, *see* 15 U.S.C. § 3431(a)(1)(B).

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[6]Section 2 of the NGA defines a "[n]atural-gas company" as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 15 U.S.C. § 717a(6).

[7]Section 717f(b) of title 15 of the United States Code states:

> (b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

15 U.S.C. § 717f(b).

In 1954 Dorchester acquired Panhandle Field gas reserves[8] and applied for a certificate of public convenience and necessity, which the federal regulatory agency issued on February 6, 1956.[9] That certificate covers the Dorchester gas wells located on gas proration units that overlap the oil proration units of the petitioners. "The initiation of interstate service pursuant to [a] certificate dedicate[s] all fields subject to that certificate." *California v. Southland Royalty Co.*, 436 U.S. 519, 525 (1978). The Dorchester gas, then, was "natural gas committed or dedicated to interstate commerce on November 8, 1978, and for which a just and reasonable rate under the Natural Gas Act was in effect on such date for the first sale of such gas," 15 U.S.C. § 3314(a). *See generally Dorchester Gas Producing Co. v. FERC*, 571 F.2d 823, 825 (5th Cir.

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[8]As the Fifth Circuit stated in reference to this same date and transaction:

> At the time of the acquisition, Dorchester Gas Producing Company did not exist. The acquiring party was Dorchester Corporation, and Dorchester Gas Producing Company was formed to hold the gas reserves in question here sometime after their acquisition. For the purposes of this case, there is no functional difference between Dorchester Corporation and Dorchester Gas Producing Company, and we shall use the name "Dorchester" throughout . . . in order to avoid confusion.

Dorchester Gas Producing Co. v. FERC, 571 F.2d 823, 825 n.1 (5th Cir. 1978).

[9]The certificate was based on a 1952 gas purchase contract executed by Dorchester's predecessor in interest in its leasehold estate. *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,046 (1985)(recommended decision). On June 7, 1954, when the federal agency began regulating interstate gas sales for resale by independent producers, the sales under the 1952 contract had triggered automatically the dedication of the gas reserves under part of the subject acreage. *Id.* at 65,033, 65,034.

1978); 15 U.S.C. §§ 717c-717d (granting federal agency jurisdiction under NGA to set "just and reasonable" rates; providing for agency hearings to establish rates). As such, it was subject to the ceiling price established by section 104 of the NGPA. 15 U.S.C. § 3314; *see also* 18 C.F.R. §§ 154.1-.310 (1988) (federal regulations establishing and regulating rate schedules and tariffs for natural gas); *id.* §§ 271.101(a), 271.401-403 (1988) (establishing price for NGPA § 104 gas).

The ALJ established that Dorchester's certificate of public convenience and necessity applied to --- and therefore dedicated to interstate commerce --- all natural gas from the subject acreage that was not casinghead gas.[10] *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,046 (1985) (recommended decision). In reaching that conclusion, the ALJ considered the geological characteristics of the Dorchester acreage, the application of Texas state law to that acreage, and a 1952 gas purchase contract that preceded the Dorchester certificate. *Id.* The ALJ examined these matters only as a necessary background to applying the relevant federal statutes to these parties. Such an examination was therefore within FERC's jurisdiction.

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[10] Again, we examine at this point only whether the ALJ -- and, consequently, FERC through its subsequent affirmation --- had statutory jurisdiction to delve into matters claimed by the petitioners to be shielded from any federal involvement. We shall take up below an examination into whether FERC's conclusions of law were, in fact, reasonable.

Because the petitioners[11] contended that the Texas pricing determinations for their wells have removed all gas produced by those wells from the dedicated gas ceiling price, FERC had to determine the scope of those pricing determinations. Section 103 of the NGPA establishes a ceiling price for "natural gas" statutorily determined "to be produced from any new, onshore production well." 15 U.S.C. § 3313(a).[12] The statutory determination is to be made by the "Federal or State agency having regulatory jurisdiction with respect to the production of natural gas." 15 U.S.C. § 3413(c)(l); *see also id.* § 3413(a)(l)(C). For the subject

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[11]As we have noted, the petitioners in this case are the oil well operators found by FERC to have violated federal law, together with some third parties that side with those operators. For the sake of convenience, we refer here to "the petitioners' wells" as meaning those wells operated by the original thirty-five operators that FERC found to have violated federal law.

[12]Section 103(c) of the NGPA states:

> For purposes of this section, the term "new, onshore production well" means any new well (other than a well located on the Outer Continental Shelf)--
> (1) the surface drilling of which began on or after February 19, 1977;
> (2) which satisfies applicable Federal or State well-spacing requirements, if any; and
> (3) which is not with a proration unit--
> (A) which was in existence at the time the surface drilling of such well began;
> (B) which was applicable to the reservoir from which such natural gas is produced; and
> (C) which applied to a well (i) which produced natural gas in commercial quantities or (ii) the surface drilling of which was begun before February 19, 1977, and which was thereafter capable of producing natural gas in commercial quantities.

15 U.S.C. § 3313(c).

acreage, that agency is the Railroad Commission of Texas (RCT). *See* 18 C.F.R. § 274.501 (1988).

When the proceedings below began, most of the petitioners' oil wells had received section 103 determinations from the RCT.[13] The ALJ approached these determinations as administratively final, *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,030 (1985) (recommended decision), and did not attempt to make new section 103 determinations, *id.* at 65,047; *see also* 15 U.S.C. § 3413(b); 18 C.F.R. § 275.202 (1988). Instead, the ALJ undertook to ascertain the scope of the section 103 determinations consistent with the federal statutory language, *see, e.g.*, 15 U.S.C. § 3313(c)(3) (barring "new, onshore production well" from being within certain pre-existing proration units). The ALJ concluded that the determinations covered "only casinghead gas." *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,030 (1985) (recommended decision). In order to arrive at that conclusion, she examined Texas state law provisions involving such matters as proration units and casinghead gas. *Id.* Again, as was the case with the ALJ's examination of the Dorchester certificate of public convenience and necessity, this examination was undertaken only as a necessary background to the application of the relevant federal statutes.

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[13]Of the 196 oil wells the petitioners operated on the subject acreage, all but 10 were collecting § 103 prices for their gas. *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,030 (1985) (recommended_decision). The remaining 10 wells were collecting # 109 prices for their gas. *Id.* "Section 109 allows ceiling prices for new natural gas that does not fit into a designated category." *Id.* Although § 109, unlike § 103, does not require an agency determination under the NGPA for the producing well, see 15 U.S.C. § 3413(a)(1), it would still, of course, be a violation of federal law to sell what is legally § 104 gas, and is not § 109 gas, at a higher price reserved for § 109 gas.

We hold that FERC's jurisdictional decisions in these proceedings had an adequate basis in law.

C.

The petitioners contend that, even if FERC had jurisdiction to examine state law issues, it should have abstained from doing so. They assert that FERC should have deferred to Texas authorities on these issues, citing primarily to the principles of *Burford*-type abstention.

Burford-type abstention is deference by a federal court in order to avoid needlessly interfering in state activities. *See Burford v. Sun Oil Co.*, 319 U.S. 315, 317-18, 327 (1943). *See generally* 17A C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 4244 (2d ed. 1988). For several reasons, however, the principles of that abstention should not control this case. First, the procedural posture here is markedly different from the one that caused concern in *Burford*. *Burford* involved a federal court's review, under diversity and federal question (due process) jurisdiction, of an RCT order concerning oil well spacing. Burford, 319 U.S. at 316-17. The federal court's review, moreover, would have preceded any review of the order by the state courts designated to review such orders under Texas law. *Id.* at 325-28. Finally, there was no federal statute or regulation at issue in that case.

By contrast, the proceedings before FERC involved a federal regulatory agency operating in the area of its expertise. The federal agency was clearly acting within its jurisdiction, and it was taking Texas statutes and regulatory determinations at their face value. A *federal* regulatory issue was the issue before

FERC. This is not *Burford*, and FERC was not required to have deferred.[14]

III.

We turn next to our review of the federal agency's findings of fact and of its decisions.

A.

The NGA and NGPA explicitly provide the scope of our review for the findings of fact, stating in identical language that "[t]he finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. § 717r(b) (section 19(b) of the NGA); *id.* § 3416(a)(4) (section 506(a)(4) of the NGPA). Here, the Administrative Procedure Act provides an identical standard. *See* 5 U.S.C. § 706(2)(E).

"[Substantial evidence] means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Richardson v. Perales*, 402 U.S. 389, 401 (1971) (quoting *Consolidated Edison Co. v.. NLRB*, 305 U.S. 197, 229 (1938)). That is, "it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury." *NLRB v. Columbian Enameling &*

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[14]In actuality, FERC did stay its proceedings in order to give the RCT time to decide certain state law issues. *Stowers Oil & Gas Co.*, 32 FERC ¶ 61,043, at 61,134-36 (1985) (opinion no. 239). FERC deferred action on *Stowers* until the RCT had completed action in a different proceeding before it and had voted to issue a memorandum to operators in the Panhandle West Gas Field. *Id.* at 61,136. FERC concluded that the RCT memorandum supported the conclusions reached by the ALJ. *Id.*

Stamping Co., 306 U.S. 292, 300 (1939).[15] It is, therefore, "something less than the weight of the evidence," and an agency's finding may meet the standard in spite of "the possibility of drawing two inconsistent conclusions from the evidence." *Consolo v. Federal Maritime Comm'n*, 383 U.S. 607, 620 (1966). This standard "frees the reviewing courts of the time-consuming and difficult task of weighing the evidence, it gives proper respect to the expertise of the administrative tribunal and it helps promote the uniform application of the statute." *Id.*

FERC made findings of fact concerning the geological characteristics of the subject acreage and of the Panhandle Field generally, the events that prefaced the parties obtaining their various leasehold interests and Dorchester obtaining its certificate of public convenience and necessity, and the geological and production realities of the various producing wells on the subject acreage. The petitioners contend that some of these findings are not supported by substantial evidence.

Specifically, the petitioners attack the evidentiary sufficiency for the ALJ's finding that they were producing gas from above the gas-oil contact, see *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,048 (1985) (recommended decision). This finding formed a basis for FERC's conclusion that the petitioners were producing dedicated gas from a Dorchester proration unit. The ALJ stated that her basis for that finding was "the totally persuasive evidentiary presentation of

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[15]The Court, in citing these same cases, has stated that "[a]lthough these two cases were decided before the enactment of the Administrative Procedure Act, they are considered authoritative in defining the words 'substantial evidence' as used in the Act." *Consolo v. Federal Maritime Comm'n*, 383 U.S. 607, 620 n.18 (1966).

the expert witnesses sponsored by [FERC's] Enforcement Staff and Dorchester." *Id.* The ALJ, furthermore, declared that the presentation's "conclusions, based on accepted scientific principles of geology, chemistry, and reservoir engineering, leave no doubt that most of the gas produced by most of the [petitioners] is not casinghead gas . . . and that most of the [petitioners] are producing gas which would otherwise be produced by Dorchester." *Id.* We find that the ALJ relied on the extensive evidence and arguments presented by the various parties in reaching her recommended decision. *See id.* at 65,033-43; *id.* app. C at 65,051-65.

The petitioners also object to the ALJ's use of "secondary evidence" to ascertain the gas-oil contact in specific wells. Furthermore, they cite expert testimony that they contend contradicts the expert testimony relied upon by the ALJ. In the final analysis, however, the petitioners' arguments point at best to the presence of some conflicts in the evidentiary record. In the light of our scope of review, that is simply not enough. After a review of the record as a whole, we conclude that the findings of fact are supported by substantial evidence.

B.

The ALJ concluded that the petitioners were producing dedicated gas from Dorchester's reserves and selling that gas at a price above the price ceiling dictated by section 104 of the NGPA. In so concluding, the ALJ examined Texas state law matters involving proration units, contract language, and the definition of casinghead gas. The definition of casinghead gas played a significant role in the ALJ's analysis, for she concluded that the reserves covered by Dorchester's certificate of public convenience and necessity did not include casinghead gas and that the scope of the petitioners' section 103 well determinations was

limited to casinghead gas. Therefore, once casinghead gas was defined, it was possible to ascertain whether the petitioners had produced gas dedicated under Dorchester's certificate or within the scope of their own well determinations.

1.

We have concluded that FERC had jurisdiction to examine these state law matters. We have concluded also that FERC need not have deferred to the state agencies or state courts. The petitioners, however, expend considerable energy contending that FERC's interpretation of Texas state law, even if within its jurisdiction, is without foundation.

"Unlike factual findings, questions of law are freely reviewable by the courts, and courts are under no obligation to defer to the agency's legal conclusions." *Pennzoil Co. v. FERC*, 789 F.2d 1128, 1135 (5th Cir. 1986). That scope of review is unchanged, of course, when the agency's conclusions of law are based upon relevant state law rather than federal law. *See Wolf v. Gardner*, 386 F.2d 295, 296 (6th Cir. 1967) (court of appeals not required to accept cabinet secretary's conclusions of law based in part on state family law); *Baber v. Schweiker*, 539 F. Supp. 993, 995 (D.D.C. 1982) (mem.) ("substantial evidence" deference "does not attach to an agency's interpretation of state law").

Nevertheless, even if not compelling, legal interpretations on a matter by administrative bodies having expertise in the area are "helpful" to reviewing courts, *Erickson Air Crane Co. v. United States*, 731 F.2d 810, 814 (Fed. Cir. 1984), and "the courts are to give some deference to the Commission's informed judgment" on such legal issues, *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 454 (1986). Generally, then, when a court reviews an agency's careful and studied

conclusions of law pertaining to a matter clearly within the agency's expertise, the court will affirm those conclusions if they are reasonable, *cf. Chapman v. United States, Dept. of Health & Human Servs.*, 821 F.2d 523, 527 (10th Cir. 1987) (agency's interpretation of statute entrusted to its administration limited to whether construction is "reasonable"), although an agency's order may not stand if the agency has misconceived the law," *SEC v. Chenery Corp.*, 318 U.S. 80, 94 (1943).

2.

The petitioners contend primarily that FERC erred in its conclusion concerning the definition of casinghead gas under Texas state law. The petitioners take the position that all gas produced from an oil well is casinghead gas. For the petitioners, then, the crucial distinction is the state statutory classification of wells into "oil wells" or "gas wells." For this position, "any well that produces one barrel or more of oil to each 100,000 cubic feet of gas," Tex. Nat. Res. Code Ann. § 86.002(6) (Vernon 1978), is an oil well, and any gas produced from that well is casinghead gas.

The Texas statutory definition of "casinghead gas" is "any gas or vapor indigenous to an oil stratum and produced from the stratum with oil," *id.* § 86.002(10). Although on its face this definition is consistent with FERC's position, the petitioners argue that their position is the correct interpretation of the legislative intent behind the statute. They point emphatically to a 1940 opinion of the Attorney General of the State of Texas, Tex. Att'y Gen. Op. No. 0-1760 (1940), which concludes that "the term 'casinghead gas' applies to all gas produced from any 'oil well' as defined in [the Texas statutes]," *id.* at 4. The petitioners contend that Texas law has consistently followed this definition, as illustrated by RCT documents and by

such Texas court decisions as *Read v. Britain*, 422 S.W.2d 902 (Tex. 1967).

FERC contends that the Texas state law definition of casinghead gas is that found upon the face of the statute. In addition, FERC points to the fact that the RCT regulations -- presumably meant to clarify any interpretative problems found in the statute's plain language -- virtually repeat the statutory language. The RCT regulations define casinghead gas as "[a]ny gas or vapor, or both, indigenous to an oil stratum and produced from such stratum with oil." Tex. Admin. Code tit. 16, § 3.69 (1986) (RCT; Oil and Gas Div.; definitions). Finally, the ALJ also noted the administrative hearing had shown "this definition [to be] supported by persuasive expert scientific and engineering testimony." *Stowers Oil & Gas Co.*, 30 FERC 63,017, at 65,046 (1985) (recommended decision).

In determining whether gas was "produced from the stratum with oil," the ALJ referred to the gas-oil contact point. *Id.* at 65,048. The ALJ determined that "Dorchester's proration unit is that portion of the reservoir *above* the gas-oil contact which lies beneath each 640-acre unit assigned to a Dorchester well." *Id.* (emphasis added). The ALJ concluded that gas production coming from above the gas-oil contact is not casinghead gas and, therefore, is gas dedicated to interstate commerce. *Id.*

In examining whether it was reasonable for FERC to have adopted its position, we note that although the authority for that position may not be unopposed, it is certainly well represented in Texas law. In addition to the statutory and regulatory language already quoted, there is virtually overwhelming support for FERC's definitional position in Texas judicial opinions handed down after FERC

issued its orders. *See Amarillo Oil Co. v. Energy-Agri Prods., Inc.*, No. C-6649, 32 Tex. Sup. Ct. J. _____ , _____ (Mar. 8, 1989; slip op. at 12) (holding that "the statutory definition of casinghead gas is not ambiguous"); *Dorchester Gas Producing Co. v. Harlow Corp.*, 743 S.W.2d at 250-51, 258 (upholding instruction charging jury that "the classification of a well by the Texas Railroad Commission does not determine whether gas produced from a well is casinghead gas"). The Texas statutes and regulations, moreover, as a whole are consistent and harmonious with FERC's position. *See, e.g.*, Tex. Nat. Res. Code Ann. §§ 86.093, 86.097 (Vernon 1978); Tex. Admin.Code tit. 16, §§ 3.10(a), 3.13(a)(l), 3.13(b)(4)(B), 3.69 (1986); RCT, *Special Rules Governing the Panhandle District*, II, at rules 1-3 (drilling rules).

FERC's position finds further support in a recent order of the RCT establishing and clarifying regulations designed in part to prevent improper production of gas, by oil well operators, from horizons that produce only gas. *See Final Order Adopting and Clarifying Rules and Regulations for the Panhandle Fields*, RCT, Oil & Gas Docket No. 10-87,017 (Jan. 11, 1989).[16] The RCT adopted verbatim the Texas statutory definition of casinghead gas. *Id.* at 7. Also, the RCT found that "[o]perators can generally use information" from several sources "in an attempt to determine the gas-oil contact in an individual oil well; but the contact cannot always be determined, and can vary substantially across the field." *Id.* at 4.

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[16]The RCT order is not final for administrative purposes until: (1) no motion for rehearing is filed within the period allowed for such motions; (2) the agency has ruled on submitted motions for rehearing; or (3) any submitted motions for rehearing have been overruled by operation of law. Tex. Rev. Civ. Stat. Ann. art. 6252-13(a), § 16(c), (e) (Vernon Supp. 1989).

The fact that the-gas-oil contact point cannot always be precisely determined apparently led the RCT to state that "regulation of the field is best implemented. without reference to an absolute gas-oil contact level," *id.* at 13. The petitioners contend that this language precludes FERC from using the gas-oil contact to determine whether gas being produced was dedicated gas. We disagree. The RCT order merely states a preference, for practical reasons, for regulation constructed without referencing a gas-oil contact. In fact, "[t]he [RCT] has zoned the Panhandle Field reservoir(s) into separate gas fields and oil fields" and "[RCT] field rules require that an oil well be perforated only in levels, sands or strata productive of oil." *Id.* at 5. This example of the RCT's continued recognition of separate producing horizons is consistent with the concept of a gas-oil contact. We hold that it was reasonable in this case for FERC to have used a gas-oil contact in determining whether dedicated gas was being sold.

We find overwhelming support for the reasonableness of FERC's definitional position. Not only is that position supported by the sources we have noted, but many of the sources cited by the petitioners are inconclusive or ambiguous. *Cf. Dorchester Producing Co. v. Harlow Corp.*, 743 S.W.2d at 250-51 (addressing statement found in *Read v. Britain*, 422 S.W.2d 902,-903 (Tex. 1967), concerning casinghead gas). For example, the 1940 Attorney General's opinion states that "[t]he statutory classifications of 'sour gas' and 'casinghead gas' are not absolutely clear," Tex. Att'y Gen. Op. No. 0-1760, at 2, but reasons that the legislature intended "to restrict the term 'casinghead gas' to gas which is produced with oil from an 'oil well,'" *id.* at 3. The opinion also states, however, that "the Legislature evidently considered that where gas is produced as a *necessary incident* to the production of oil

from an oil well, the value of the oil produced would warrant the use of the casinghead gas 'for any beneficial purpose.'" *Id.* at 4 (emphasis added). Such statements, together with the opinion's definition of casinghead gas as "gas produced with oil from an oil well," *id.* at 3, demonstrate the ambiguity of the opinion as it was cited by the parties before FERC. Furthermore, after FERC had concluded its proceedings, the Texas Supreme Court explicitly disapproved the opinion, on the grounds that it failed to follow the plain meaning of the statutory definition of casinghead gas. *See Amarillo Oil*, 32 Tex. Sup. Ct. J. at _____ (slip op. at 12).

Upon review, we find that FERC's conclusions of state law, including the Texas state law definition of casinghead gas, are reasonable.

C.

The petitioners also contend that FERC erred in its conclusion that casinghead gas was the only natural gas covered by the section 103 well determinations for the petitioners' oil wells.

1.

RCT made those well determinations pursuant to sections 503(a)(l)(C)[17] and 503(c)(1)[18] of the NGPA.

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[17]Section 503(a)(l)(C) of the NGPA provides:

(a) General rule.--
(1) Determination.--If any State or Federal agency makes any final determination which it is authorized to make under subsection (c) of this section for purposes of--

. . . .

(C) applying the definition of new, onshore production well under section 3313(c) of this title;

. . . .

(footnotes continued on next page)

As such, they determined that the petitioners' applicable wells were "new, onshore production wells" within the meaning of section 103 of the NGPA and that, consequently, natural gas produced under section 103 from those wells was subject to the ceiling price set by the NGPA for such gas. *See* 15 U.S.C. § 3313. The petitioners contend that all natural gas subsequently produced by those wells is removed from FERC's jurisdiction by section 601(a)(l)(B)(iii) of the NGPA. That section provides that the jurisdiction of FERC under the NGA

> shall not apply solely by reason of any first sale of natural gas which is committed or

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(footnotes continued from previous page)

> such determination shall be applicable under this chapter for such purposes unless such determination is reversed under the provisions of subsection (b) of this section or unless such State or Federal agency has waived its authority under the provisions of subsection (c) of this section.

15 U.S.C. § 3413(a)(l)(C). Subsection (b) of the section provides for FERC review of the initial determination. *Id.* § 3413(b). The RCT is the jurisdictional "State or Federal agency" for section 103 determinations applicable to the petitioners' Panhandle Field wells. *See* 18 C.F.R. § 274.501(a)(2) (1988).

[18]Section 503(c)(l) of the NGPA provides:

> (c) State authority.--
> (1) General rule.--A Federal or State agency having regulatory jurisdiction with respect to the production of natural gas is authorized to make determinations referred to in subsection (a) of this section.

15 U.S.C. § 3413(c)(l). The RCT is the "Federal or State agency" that has regulatory jurisdiction over the production of natural-gas by the petitioners' Panhandle Field wells. *See* 18 C.F.R. § 274.501(a)(2) (1988).

> dedicated to interstate commerce as of November 8, 1978, and which is--
>
> . . . .
>
> (iii) natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title).

Id. § 3431(a)(l)(B)(iii) ("section 3313(c) of this title" is § 103(c) of the NGPA).

FERC affirmed the ALJ's conclusion that the section 103 well determinations did not remove any dedicated gas from FERC's NGA jurisdiction. Although the petitioners at times characterize that conclusion as an erroneous interpretation of state law, in fact section 103 determinations have their legal significance as part of the *federal* regulatory structure of the NGPA. The ALJ approached the section 103 determinations as valid and administratively final. The ALJ simply applied the principles and provisions of the NGPA to the well determinations.

FERC arrived at its conclusion by examining the statutory requirements of a section 103 determination and applying those requirements to RCT's determination affecting the petitioners' wells. Section 103 of the NGPA establishes the ceiling price for natural gas produced by a new, onshore production well," 15 U.S.C. § 3313(a),(b), and section 103(c) states that, for the purposes of section 103

> the term "new, onshore production well" means any new well (other than a well located on the Outer Continental Shelf)--
>
> (1) the surface drilling of which began on or after February 19, 1977;

> (2) which satisfies applicable Federal or State well-spacing requirements, if any; and
>
> (3) which is not within a proration unit--
>
> (A) which was in existence at the time the surface drilling of such well began;
>
> (B) which was applicable to the reservoir from which such natural gas is produced; and
>
> (C) which applied to a well (i) which produced natural gas in commercial quantities or (ii) the surface drilling of which was begun before February 19, 1977, and which was thereafter capable of producing natural gas in commercial quantities.

Id. § 3313(c). The statute therefore provides that a section 103 well cannot be located within a preexistent proration unit[19] which applies to the same reservoir[20]

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[19]The NGPA defines the term "proration unit" to mean

> (A) any portion of a reservoir, as designated by the State or Federal agency having regulatory jurisdiction with respect to production from such reservoir, which will be effectively and efficiently drained by a single well;
>
> (B) any drilling unit, production unit, or comparable arrangement, designated or recognized by the State or Federal agency having jurisdiction with respect to production from the reservoir, to describe that portion of such reservoir which will be effectively and efficiently drained by a single well; or

(footnotes continued on next page)

from which the section 103 well produces its natural gas, and which applies to a well that produced natural gas in commercial quantities (or at least that was begun before February 19, 1977, and sometime later became capable of producing natural gas in such quantities).

The Dorchester gas proration units in the Panhandle Field predated the petitioners' section 103 wells and were producing natural gas. Furthermore, if the petitioners' wells were producing gas from within a Dorchester proration unit, they would be "within a proration unit . . . which was applicable to the reservoir from which [the petitioners'] natural gas is produced." *Id.* § 3313(c)(3). The petitioners' section 103 wells,

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(footnotes continued from previous page)

> (C) if such portion of a reservoir, unit, or comparable arrangement is not specifically provided for by State law or by any action of any State or Federal agency having regulatory jurisdiction with respect to production from such reservoir, any voluntary unit agreement or other comparable arrangement applied, under local custom or practice within the locale in which such reservoir is situated, for the purpose of describing the portion of a reservoir which may be effectively and efficiently drained by a single well.

15 U.S.C. § 3301(8)

[20]The NGPA defines the term "reservoir" to mean any producible natural accumulation of natural gas, crude oil, or both, confined--

> (A) by impermeable rock or water barriers and characterized by a single natural pressure system; or
>
> (B) by lithologic or.structural barriers which prevent pressure communication.

15 U.S.C. § 3301(6).

therefore, could not be within a Dorchester proration unit, although the surface areas of the Dorchester gas proration units and of the petitioners' oil proration units overlap. By following that analysis, the ALJ concluded that the petitioners' section 103 determinations were applicable only to natural gas produced by the petitioners' oil wells from below the gas-oil contact. *Stowers Oil & Gas Co.*, 30 FERC ¶ 63,017, at 65,047 (1985) (recommended decision). The RCT had declared that its section 103 determinations for the petitioners' wells were made in compliance with all applicable statutory requirements. In reaching her conclusion, the ALJ took the RCT at its word and considered the statutory requirements to have been met.

2.

The petitioners contend that the section 103 well determinations cover all natural gas produced by their wells, even if those wells are deemed to be within a previously existing Dorchester gas proration unit. The petitioners arrive at this conclusion by pointing to the statutory language defining "proration unit" under the NGPA. That definition ties a proration unit to the part of a reservoir that will be "effectively and efficiently drained by a single well." 15 U.S.C. § 3301(8). The federal regulations provide, furthermore, that the jurisdictional agency may make a finding that a well, the drilling of which is begun on or after February 19, 1977,[21] is needed "to effectively and efficiently drain" a portion of an already existing proration unit. 18 C.F.R. § 271.305(b)(l). Section 103 pricing categories may apply to natural gas produced by a well that is covered by such a finding. *Id.* §§ 271.301, 271.305(b)(1). Here,

[21]The NGPA requires that for all # 103 wells the "surface drilling" must have begun "on or after February 19, 1977." 15 U.S.C. § 3313(c)(l).

that agency, the RCT, stated that the petitioners' section 103 determinations met all the applicable statutory requirements. The petitioners argue, therefore, that the RCT made an implicit finding that the petitioners' wells were needed in order to drain existing Dorchester proration units effectively and efficiently. We disagree.

The petitioners section 103 wells were oil wells. It is unreasonable to interpret a section 103 determination for an *oil* well as implicitly making a finding concerning the drainage of a Dorchester *gas* proration unit. Further, the federal regulations clearly state that

> the jurisdictional agency must *explicitly* find that the well is necessary to effectively and efficiently drain a portion of the reservoir covered by the proration unit which cannot be effectively and efficiently drained by any existing well within the proration unit. This explicit finding must be based on appropriate geological and engineering data and such data must be included in the notice of determination submitted to the Commission.

Id. § 271.305(b)(l) (emphasis added); see *Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207, at 61,421 n.36 (1985)

(order denying stay and rehearing).[22] Here, no such explicit finding was made.

As FERC noted in its order denying motions for stay and requests for rehearing, "[i]t is clear from the legislative history that the section 103 price was not intended to apply to gas that could be produced by an existing well." *Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207, at 61,421 (1985). Senator Pearson stated, during floor debate on the NGPA, that section 103 prices were meant to apply only to "natural gas sold from new reservoirs and new extensions of reservoirs." 123 Cong. Rec. 30,373 (1977), *quoted in Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207, at 61,421 (1985) (order denying stay and rehearing). "The economic incentives . . . should only be applicable to truly new gas discoveries." *Id., quoted in Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207, at 61,421 (1985) (order denying stay and rehearing).

Section 103 operates to prevent the petitioners from obtaining a section 103 price for natural gas produced from an existing Dorchester proration unit. The petitioners are entitled to a section 103 price for gas produced by their section 103 oil wells only when that gas is produced from their oil proration units and is therefore casinghead gas, that is gas "indigenous to an oil stratum and produced from the stratum with oil." Tex. Nat. Res. Code Ann. § 86.002(10). Such gas

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[22]An exception to this procedure did exist for "*second* wells in a proration unit [the drilling of which was begun] after February 19, 1977, and before January 1, 1979, or for which a drilling permit was issued before January 1, 1979." *Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207, at 61,421 n.36 (1985) (order denying stay and rehearing). That exception was required because of a transitional period during which the regulations implementing the NGPA were not yet in place. *Id.* None of the petitioners' wells met the requirements of the transitional rules. *Id.*

will be from below the gas oil contact and will not be part of Dorchester's dedicated reserves. We affirm the conclusions of law utilized by FERC in reaching its decision.

D.

In addition to a review of the agency's findings of fact and conclusions of law, judicial review of agency action also entails an examination of the agency's reasoning process. The Supreme Court has declared that "the generally applicable standards of [5 U.S.C.] § 706 require the reviewing court" to determine that the agency's "actual choice" was not "arbitrary [and] capricious." *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 415-16 (1971); *accord Bowman Transo., Inc. v. Arkansas-Best Freight Sys.*, 419 U.S. 281, 284 (1974) (noting that "though an agency's finding may be supported by substantial evidence . . . it may nonetheless reflect arbitrary and capricious action"); *Pennzoil Co. v. FERC*, 789 F.2d at 1139 n.31 (citing 5 U.S.C. § 706(2)(A) for "arbitrary and capricious" standard in reviewing "agency decision"). The Court has stated that:

> The scope of review under the "arbitary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made." *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168, 83 S.Ct. 239, 245-246, 9 L.Ed.2d 207 (1962). In reviewing that explanation, we must "consider whether the decision was based on a consideration of the relevant factors and

> whether there has been a clear error of judgment."

Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (quoting Citizens to Preserve Overton Park, 401 U.S. at 416).

Applying this standard to FERC's orders, we find an extensive examination of "the relevant data" and a clearly articulated "rational connection" between the agency's findings and its final decision. We affirm FERC's orders upon review.

IV.

Finally, we address a procedural issue raised by the petitioners. On February 15, 1984, FERC issued its show cause order against those petitioners that operated oil wells on the subject acreage. *Stowers Oil & Gas Co.*, 26 FERC ¶ 61,207 (1984). The petitioners contend that the show cause order did not give them adequate notice of the theory under which FERC would proceed. According to the petitioners, the order "was premised on the existence of two separate and identifiable producing formations in the West Panhandle Field": a "dry gas" producing zone coterminous with the brown dolomite formation, and an "oil stratum" from which "casinghead gas" was produced. The petitioners assert that FERC continued under this theory up to the point of its offering rebuttal evidence before the ALJ. At that point, they argue, the enforcement staff presented a new theory of the case: one based upon a state law division of the Panhandle Field along a horizontal gas-oil contact, with gas proration units located above the gas-oil contact and oil proration units located below it.

The petitioners' contention overstates the case. The show cause order properly stated that it "neither makes findings of fact nor reaches conclusions of law with regard to the [petitioners'] alleged acts and practices." *Id.* at 61,480. The order, furthermore, asserted that "[t]he brown dolomite stratum is productive only of dry gas *at the level* at which the operators of each of the oil wells . . . have perforated or have caused the perforation of such oil wells." *Id.* at 61,478 (emphasis added). In its order denying the motions for stay and the requests for rehearing, FERC declared that "the show cause order set the inquiry broadly enough to encompass the concept of the gas-oil contact." *Stowers Oil & Gas Co.*, 33 FERC ¶ 61,207, at 61,423 (1985). We agree.

V.

FERC had jurisdiction to consider those matters examined by it in the adjudicatory hearing. FERC's findings of fact are based on substantial evidence, and its conclusions of law are reasonable. We find no procedural grounds for overturning the orders. FERC's orders are therefore AFFIRMED.

EXHIBIT B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 239

Stowers Oil & Gas Company, *et. al.*

Docket No. GP84-23-000

OPINION AND ORDER

Issued: July 12, 1985

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Stowers Oil & Gas Company, *et al.*

Docket No. GP84-23-000

OPINION NO. 239

APPEARANCES

Thomas K. Anson and *P. M. Schenkkan* for Anadarko Production Company and Pan Eastern Exploration Company.

Robert W. Clark, III, *Maston C. Courtney* and *D. Patrick Lono* for Cabot Pipeline Corporation.

William M. Lange and *Nancy A. White* for Colorado Interstate Gas Company.

Thomas H. Burton for Conoco, Inc.

Norman A. Flaningam and *Karol Lyn Newman* for Consolidated Royalty Owners, Inc.

Philip R. Ehrenkranz, *R. David Kitchen* and *James L. Trump* for Dorchester Gas Producing Company.

Paul W. Fox and *Charles H. Shoneman* for Getty Oil Company.

Jody G. Sheets for Lucky Bird Petroleum.

Michael H. Loftin and *R. A. Wilson* for Meyers Farms, Inc.

J. Paul Douglas for Mobil Producing Texas and New Mexico, Inc.

Joseph Wells for Natural Gas Pipeline Company of America.

Patrick J. McCarthy and *Steve Stojic* for Northern Natural Gas Company.

Jennifer A. Cates and *Joe Cochran* for Phillips Petroleum Company and Phillips Oil Company.

Larry J. Laurent, *W. Scott McCollough*, *Jim Mattox*, and *David R. Richards* for the State of Texas.

Jerry D. Courtney, *Ivan D. Hafley*, *Charles A. Moore*, *Robert W. Perdue*, *Daniel G. Shillito*, and *Michael K. Swan* for Stowers Oil & Gas Company, et al.

Joe H. Foy and *Gail S. Gilman* for J. B. Watkins.

Nathan Fishkin, *Robert Fleishman*, *Michael T. Mishkin* and *Steven Ross* for the Federal Energy Regulatory Commission's Enforcement Staff

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A. G. Sousa, Oliver G. Richard III and Charles G. Stalon.

Stowers Oil & Gas Company, *et al.*

Docket No. GP84-23-000

OPINION NO. 239

OPINION AND ORDER

(Issued July 12, 1985)

I. INTRODUCTION

In 1983, the Enforcement staff of the Federal Energy Regulatory Commission (Commission) began an inquiry into natural gas sales by Stowers Oil & Gas Company and thirty-six other oil well operators (respondents) in the Texas Panhandle West Gas Field. It was alleged that respondents have been producing gas from reserves belonging to Dorchester Gas Producing Company (Dorchester) which were committed or dedicated to interstate commerce and selling the gas, in most instances, in intrastate commerce at prices in excess of the maximum lawful price under section 104 of the Natural Gas Policy Act of 1978 (NGPA).[1] The matter was set for an expedited hearing before Judge Brenda Murray, and the respondents were ordered to show cause why they

[1] 15 U.S.C. §§ 3301-3432 (1982).

should not be found in violation of section 7(b) of the Natural Gas Act (NGA)[2] for the alleged diversion of dedicated reserves, and of section 504(a)(l) of the NGPA for the alleged overcharges.[3]

After extensive discovery, a hearing was conducted in July and August of 1984. On January 16, 1985, the presiding judge issued a Recommended Decision finding that all but two of the respondents were violating either section 7(b) of the NGA or section 504(a)(l) of the NGPA, or both,[4] and recommended that they be ordered immediately to cease the unlawful diversion and overcharging. In reaching her decision the judge found that under Texas law casinghead gas cannot be produced above the gas oil contact and therefore production through high perforations in an oil well was gas production. The judge also recommended further investigation of the activities of two of the respondents, Meyer Farms, Inc., and J.B. Watkins.

The Commission in this order affirms the presiding judge's Recommended Decision holding that the respondents have violated either section 7(b) of the NGA or section 504(a)(l) of the NGPA, or both, and orders that they immediately cease the unlawful diversion and overcharging. Further, the Commission sets forth the procedures to be followed for continued investigation of Meyer Farms, Inc. and J.B. Watkins.

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[2] 15 U.S.C. §§ 717-717w (1982).

[3] 26 FERC ¶ 61,207 (1984).

[4] 30 FERC ¶ 63,017 (1985).

II. PROCEDURAL ISSUES/DISPOSITION OF MOTIONS

Certain motions have been filed, either as part of the briefs on exceptions[5] or separately, which require

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[5]On February 8 and 15, 1985, the Commission issued orders allowing the submission of exceptions to the Recommended Decision, (30 FERC ¶¶ 61,125 and 61,150.) As of February 25, 1985, timely briefs on exceptions were filed by: Stowers Oil & Gas Company, *et al.*; Cabot Pipeline Corporation; Consolidated Royalty Owners; Dorchester Gas Producing Company; Lucky Bird Petroleum, Inc.; Getty Oil Company; State of Louisiana Interstate Oil Compact Commission; J.B. Watkins and Tadlock Production, *et al.*, brief *Amicus Curiae*. Tadlock Production, *et al.*'s *Amicus* brief is accepted for filing, but the Tadlock *Amici* are not parties to this proceeding. *See* Rule 214 of the Commission's Rules of Practice and Procedure. 18 C.F.R. § 385.214 (1984). On March 5, 1985, staff filed an answer in opposition to the motion of the Tadlock *Amici* for leave to file their brief.

On February 25, 1985, the State of Louisiana and the Interstate Oil Compact Commission (IOCC) and on March 6, 1985, the Oklahoma Corporation Commission (OCC) filed their briefs on exceptions late. On March 6, 1985, Dorchester and on March 7, 1985, Phillips Petroleum Company (Phillips) filed their answers in opposition to Tadlock's *Amici* motion and to the untimely motions of Louisiana and the IOCC to intervene. On March 12, 1985, Dorchester filed an answer in opposition to the untimely motion of the OCC for leave to intervene. Finally, on March 13, 1985, Phillips filed an answer in opposition to the OCC's motion for late intervention.

For good cause shown, the late interventions will be granted. Accordingly, Phillips' motion for late intervention is granted, and its answer in opposition to the late intervention of OCC is denied. The late motions to intervene of Northwestern Public Service Company, and the Illinois Power Company, are granted.

Finally, the *Stowers* group, Lucky Bird Petroleum, Inc. and J.B. Watkins requested dismissal from these proceedings. Those requests are denied.

disposition. All briefs on exceptions were considered by the Commission in reaching a decision.

On February 25, 1985, Stowers Oil & Gas Company, *et al.* filed a motion requesting oral argument. That motion is denied.

On February 25, 1985, staff moved that the Railroad Commission of Texas (RRC) Examiners' Proposal for Decision in Docket No. 10-77,314, *Application of Phillips Petroleum Company to Amend Rules for Various Fields in the Panhandle District*, (Phillips) be received in the record as a public document item by reference under Rule 508(c).[6] On May 21, 1985, staff moved that the Final Order in the *Phillips* proceeding, issued by the RRC on May 13, 1985, be received in evidence. We find the RRC Examiners' Proposal, which was issued February 1, 1985, and the RRC's Final Order, issued May 13, 1985, to be public documents admissible as items by reference under Rule 508(c).[7] On June 18, 1985, Cabot Pipeline Corporation filed a motion requesting that the transcript of the June 17, 1985, RRC meeting be added to the *Stowers* record. In addition, to complete the record in *Stowers*, we will add the transcripts of the June 10 and July 8 RRC meetings and copies of the July 8 memorandum and letter approved by the RRC. Since the Examiner's Proposal, the RRC's Final Order,

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[6]18 C.F.R. § 385.508(c) (1984).

[7]On March 4, 1985, Northern Natural Gas Company filed an answer in support of staff's motion. On March 11, 1985, the State of Texas filed in opposition to make clear that the RRC Examiner's Proposal is not Texas law until adopted by the RRC. Upon consideration, we find it sufficiently related to this proceeding since it was adopted by the RRC's "Final Order" of May 13, 1985 and is necessary to complete this record. The RRC denied rehearing in *Phillips* on June 17, 1985.

and the RRC transcripts address issues that were the subject of several admitted exhibits, and since they concern the same subject matter as testimony already certified by the judge, staff's and Cabot's motions are granted.[8]

III. RELATED RAILROAD COMMISSION OF TEXAS ACTIONS

On March 12, 1985, the RRC requested this Commission to stay its consideration of Judge Murray's Recommended Decision in order to give the RCC time to decide certain issues of state law, which the RRC assured us were common to both the *Stowers* case and to the *Phillips* case, then pending before the RRC. In response to the RRC's request, we issued a Notice postponing consideration of the Recommended Decision in *Stowers*, granting the parties fifteen days to respond to the RRC's request, and requesting the RRC to advise us regarding the status of the *Phillips* matter within forty-five days.[9]

On May 13, 1985, the RRC issued its Final Order adopting with slight modification the RRC Examiners' Recommended Proposal for Decision in the *Phillips* case. In response, on May 22, 1985, we issued an Order Setting Issues for Oral Argument, granting the RRC

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[8]In addition, staff (and Dorchester) moved that a document previously offered but not yet ruled upon be entered into the record. This document, a motion to vacate a judgment in the *Dorchester v. Harlow* state court action, was tendered on January 14, 1985. The judge did admit as Exhibit 620 the *Harlow* Court's order vacating judgment, but not the motion to vacate, which shows the grounds on which vacation was sought. Since the vacation order was admitted, the "Joint Motion to Vacate" should also be admitted. Accordingly, staff's and Dorchester's request is granted.

[9]30 FERC ¶ 61,317 (March 12, 1985).

party status and requesting the RRC and other parties to explain:

> (1) how the [R]RC decision in *Phillips* resolves state law issues present in *Stowers* 7/ as the [R]RC has asserted in its petition for stay; and (2) whether it is still necessary to entertain the stay or whether, in light of *Phillips*, the petition for stay is now moot.
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> 7/ For example, such issues include the propriety of what have been called "high perforations" and the definition of "oil" and "casinghead" gas.

On May 31, 1985, the RRC filed a notice (A) declining to become a party to [the *Stowers*] proceeding and, (B) advising us of possible further proceedings at the State level. The RRC further indicated that "the propriety of 'high perforations' and the definition of casinghead gas . . . as it turns out were [issues] not reached in the *Phillips* case." The RRC added that these issues would be addressed at its June 3, 1985 meeting.

While these issues were addressed at the RRC's meeting on June 3, 1985, the RRC postponed further consideration until June 10, 1985.

Subsequently, on June 6, 1985, we issued an Order Clarifying Oral Argument Procedures, confirming the RRC's party status and urging its participation in the oral argument which we had scheduled for June 14 to consider the RRC's renewed request for stay in *Stowers*.

On June 10, 1985, the RRC voted to ensure compliance with certain of its Panhandle Field Rules[10] governing casinghead gas production and high perforations. Specifically, the RRC voted to issue notices to operators in the Panhandle West Gas Field which would have stated:

> Completing an oil well or working an oil well over so that any portion of the producing interval is above the gas-oil contact is not consistent with Special Orders Nos. 10-316 and 10-3087.

Additionally, the notices which the RRC initially approved on June 10 would have stated:

> If a well in the Panhandle Fields was spudded on acreage already assigned to either an oil well or a gas well in a Panhandle Field and the producing intervals of the two wells overlap, the well cannot qualify under Section 103 unless the Commission makes a finding that the later well is necessary to effectively and efficiently drain the portion of the reservoir covered by the pre-existing proration unit.

On June 11, 1985, in a letter to this Commission, the RRC's Special Counsel clarified the RRC's actions

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[10]Rule No. 3 of Oil and Gas Circular 16-B; Special Order No. 10-316; and Special Order No. 10-3087. *See, e.g.*, "Memorandum from the Railroad Commission to All Operators in the Panhandle Fields; Subject: Oil & Gas Well Completions in the Panhandle Fields," dated June 6, 1985. These rules require that the dry "lime gas" formation be cemented off from other formations; that no gas or oil well be permitted to produce gas "from different levels, sands or strata at the same time through the same string of casing;" and that the gas-oil ratio "be kept as low as possible."

taken in the *Phillips* proceedings and on the state law issues regarding high perforations and casinghead gas, stating:

> In recognition that it did not reach certain issues raised in the Phillips case (for example, the high perforations and definition of casinghead gas issues) ... [t]he RRC considered those issues outside the context of a contested case on June 3, and, following lengthy discussion, postponed action on those issues until June 10 . . . . Yesterday, the RRC took action with respect to the matters which it considered on June 3 which action culminated in the issuance of the attached two notices.

However, no notices were attached to the RRC Special Counsel's letter. Observing that the RRC's action essentially resolved the state law issues related to *Stowers*, on June 12, 1985, we cancelled oral argument in the *Stowers* case recognizing that the RRC's petition for stay was moot in light of its action on June 10.

At its next meeting on June 17, 1985, the RRC reviewed its previous decision to issue notices to operators interpreting Panhandle Field Rules in Panhandle West Gas Field and rescinded its decision of June 10, 1985, to issue the notices, never having issued the notices to the operators. Although the decision to issue the notices to the operators was rescinded on June 17, the statement by the RRC on high perforations and casinghead gas which was included in the notices was totally consistent with the Commission's Recommended Decision in *Stowers*.

After deciding that it needed additional time to resolve the high perforations and casinghead gas issues, the RRC postponed consideration of the matter

until its meeting on June 24, 1985. However, the matter was not discussed either at the June 24 meeting, or at the July 1, 1985 RRC meeting.

On July 8, 1985, the RRC voted to issue a memorandum to the operators in the Panhandle West Gas Field which enunciates the applicable field rules, statewide rules and statutes and requires the operators to file updated information on their oil and gas wells.[11] Specifically, the memorandum states:

> Completing an oil well or working over an oil well so that any portion of the producing interval is above the gas-oil contact may not be consistent with the above-cited orders, rules and statutes. Likewise, completing a gas well or working over a gas well so that any portion of the producing interval is below the gas-oil contact may not be consistent with the above-cited orders, rules and statutes.

The July 8 memorandum is similar to the June 10 unissued notices, except that any presumption of violation by the operators in the Texas Panhandle West Gas Field has been removed from the text of the July 8 memorandum.

In addition to deciding to issue the memorandum, on July 8 the RRC also voted to issue a letter to the operators in the Panhandle West Gas Field setting forth the qualifications necessary to be

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[11]The memorandum cites Rule No. 3 of Oil and Gas Circular 16-B; Special Order No. 10-316, dated May 4, 1938; Special Order No. 10-3087, effective December 1, 1941; Statewide Rules 10 and 13; and Texas Natural Resources Code § 86.012 and § 86.097.

classified as a gas well under section 103 of the NGPA. The letter states:

> . . . a well cannot be spudded within an existing proration unit applicable to the reservoir from which the subject well is producing gas. If a well in the Panhandle Fields was spudded on acreage already assigned to either an oil well or a gas well in a Panhandle Field and the producing intervals of the two wells overlap, the well cannot qualify under Section 103 unless the Commission makes a finding that the later well is necessary to effectively and efficiently drain the portion of the reservoir covered by the pre-existing proration unit. The Commission will not consider making such a finding for any well which is not in compliance with all applicable rules and regulations, including those regarding proper perforations and completions.

At the RRC's request, we deferred action on *Stowers* for several months to allow the RRC sufficient time to act on these state law issues. The position taken by the RRC in voting to issue the memorandum and letter to the operators in the Panhandle West Gas Field, along with the RRC's legal analysis, discussions and statements fully support this Commission's Recommended Decision. Furthermore, the Recommended Decision finds that the Texas statutes and field rules are unambiguous and consistent with the purposes of the NGA and NGPA.[12]

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[12]For further general confirmation that there is a meaningful distinction under Texas law between casinghead gas that is necessarily produced with oil and other gas *see* Colorado Interstate Gas Company v. Hufo Oils, Lynn S. Hunt and Carl C. Foulds, No. M0-84-CA-58 (W.D. Tex. June 20, 1985).

IV. J.B. WATKINS AND MEYER FARMS

We find that evidence of NGA or NGPA violations is inconclusive as to J.B. Watkins and Meyer Farms. Consequently, the Commission directs staff, utilizing an expert if necessary, to gather data and conduct a recombined fluid sample analysis or any other test(s) necessary on the wells in question to determine whether J.B. Watkins and Meyer Farms are in violation of the Natural Gas Act and/or the Natural Gas Policy Act. Within forty-five days of the issuance of this order, the results of staff's additional tests will be presented to the presiding judge in the form of prepared direct testimony. At the same time, respondents J.B. Watkins and Meyer Farms may present any prepared testimony of their own. The presiding judge, within two weeks following the filing or the prepared testimony, will allow cross-examination of any witness(es) resulting from the filing of prepared testimony. Based upon the additional record compiled in this matter, the presiding judge will file with the Commission appropriate recommendations with respect to J.B. Watkins and Meyer Farms within seventy-five days of the issuance of this order.

V. CONCLUSION

The Commission finds after careful review and due consideration of the recommended decision and the findings of fact and conclusions of law contained therein, as well as all briefs, motions and other documents entered into the record subsequent to the Recommended Decision, that the respondents in the Panhandle West Gas Field are in violation of section 7(b) of the NGA for the diversion of dedicated reserves and section 504(a)(l) of the NGPA for the over charges. Therefore, we affirm the *Stowers* Recommended Decision in its entirety, including all findings of fact and conclusions of law.

The Commission orders:

(A) All respondents, (except J.B. Watkins and Meyer Farms, Inc.) shall immediately cease and desist from selling natural gas from their wells on the acreage subject to this proceeding in the Panhandle West Gas Field in violation of section 7(b) of the Natural Gas Act and section 504(a) of the Natural Gas Policy Act as set forth in the Recommended Decision issued January 16, 1985.

(B) Enforcement staff is authorized to take all necessary action to accomplish the cessation of the NGA and NGPA violations.

(C) The procedure is set forth in the body of this Opinion and Order to determine the possible violations of the NGA and/or NGPA by Meyer Farms and J.B. Watkins.

(D) J.B. Watkins and Meyer Farms must allow access to the subject wells for the purpose of gathering data and conducting a recombined fluid sample analysis or any other test(s) necessary on the subject wells to determine if a violation of the NGA and/or NGPA has occurred.

(E) The proceeding is remanded to the presiding judge to set a procedural schedule to consider appropriate remedies.

By the Commission. Commissioner Richard's separate statement is attached.

(S E A L)

Kenneth F. Plumb,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Stowers Oil & Gas Company, *et al.*

Docket No. GP84-23-000

(Issued July 12, 1985)

Separate Statement of Commissioner Richard:

I agree with the decision but want to make clear that on the state law controversy my agreement is based on the discussion of the Texas Railroad Commission's (TRC) actions on page 7-9.

It is also my understanding from our staff that the TRC has not asked us to defer our consideration of this case until they obtain and analyze more information nor has it claimed that the factual findings by us would intrude on their jurisdiction. Since I am departing the Commission, if later a request is lodged, my fellow Commissioners may wish to entertain the TRC's views on the subject in this important area of the historic jurisdictional role.[1]

As I have earlier stated:

[T]he real concern should be the federal government's understanding and proper respect for the

[1]This Commission in this case has surely shown this concern.

states' historic and future autonomy, with the goal being active cooperation rather than confrontation.[2]

Oliver G. Richard III
Commissioner

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[2]Richard, *Appeal from Jarndyce v. Jarndyce: The State Role Under the Natural Gas Policy Act of 1978*, 41 La. L. Rev. 147, 172, (1980).

EXHIBIT C

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Raymond J. O'Connor, Chairman;
A. G. Sousa and
Charles G. Stalon.

Stowers Oil & Gas Company, *et al.*

Docket Nos. GP84-23-000,
and GP84-23-012 through -021

ORDER DENYING MOTIONS FOR STAY AND REQUESTS FOR REHEARING

(Issued November 13, 1985)

I. INTRODUCTION

On July 12, 1985, the Federal Energy Regulatory Commission (Commission) issued Opinion No. 239[1] in the Stowers Oil & Gas Company, *et al.* (Stowers) proceeding. That opinion and order adopted the administrative law judge's Recommended Decision[2] issued on January 16, 1985, which ordered thirty-five respondents to cease and desist from selling natural gas in violation of section 7(b) of the Natural Gas Act (NGA)[3] and/or section 504(a) of the Natural Gas Policy Act (NGPA).[4] Opinion No. 239 also ordered further investigation of two other respondents to determine

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[1] 32 FERC ¶ 61,043 (1985)

[2] 30 FERC ¶ 63,017 (1985).

[3] 15 U.S.C. § 717f(b) (1982).

[4] 15 U.S.C. § 3414(a) (1982).

whether there are possible violations of the NGA and/or NGPA, and directed the presiding judge to begin the remedy phase.

On July 29, 1985, Stowers filed a motion for stay of Opinion No. 239 with an accompanying memorandum, and on August 9, 1985, respondent Lucky Bird Petroleum (Lucky Bird) filed a supplemental motion for stay incorporating Stowers' motion and memorandum. In addition, Lucky Bird stated that unless a stay is granted it will be unable to comply with certain well testing orders of the Railroad Commission of Texas (RRC) because the gas produced during a test could neither be sold under Opinion No. 239 nor flared under state regulations. Timely answers in opposition to these motions for stay were filed.[5]

On August 9 and August 12, 1985, timely applications for rehearing of Opinion No. 239 were filed.[6] On August 26, 1985, Dorchester filed an answer in opposition to the supplemental motion for stay of

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[5]Phillips Petroleum Company (Phillips), Natural Gas Pipeline Company of America (Natural), the Enforcement Staff of the Commission (Staff), Northern Natural Gas Company a Division of Internorth, Inc. (Northern), and Dorchester Gas Producing Company (Dorchester) filed timely answers.

[6]Cabot Pipeline Corporation (Cabot), Getty Oil Company (Getty) (Texaco Producing Inc. advised the Commission on August 16, 1985, that it had succeeded to the interest of Getty herein), J.B. Watkins, Lucky Bird, the State of Texas (Texas), Stowers, Consolidated Royalty Owners, Inc. (CRO), Walker Operating Corporation (Walker Corp.), Prairie Oil Company, et al. (Prairie Group), and the RRC filed timely applications for rehearing. The RRC accompanied its request for rehearing with a motion seeking leave to intervene out-of-time in order to file its rehearing request. The RRC has already been granted intervenor-party status in this proceeding, as was made clear by our "Order Clarifying Oral Argument Procedures," issued June 6, 1985. 31 FERC ¶ 61,293 (1985)

Lucky Bird and to the motion to intervene of the RRC. On August 28, 1985, the Commission issued a "tolling" order for the sole purpose of further consideration.

Herein the Commission addresses the merits of the issues raised in both the motions for stay and the requests for rehearing, and denies both the motions for stay and the requests for rehearing for the reasons discussed below.

II. DISCUSSION

A. *Motions for Stay*

Lucky Bird's motion for stay stresses an interpretation of Opinion No. 239 which Lucky Bird argues would preclude testing the subject wells under the RRC's *Phillips* order of May 13, 1985.[7]

1. *Well Testing*

We believe it is important to answer the question as to whether or not testing is allowed at the outset, before addressing the motions for stay. Opinion No. 239 does not preclude any testing required by the RRC in *Phillips*. In fact, Opinion No. 239 does not require respondents to cease *all* gas production from their wells. It does require respondents to cease all gas production which is in violation of the NGA or the NGPA.

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[7]RRC Docket No. 10-77,314, *Application of Phillips Petroleum Company to Amend Rules for Various Fields in the Panhandle District (Phillips)*. The Stowers' Stay Memorandum makes the same argument at 20-22.

Under the *Phillips* order,[8] oil wells that are attached to low temperature extraction (LTX) units must be retested to determine whether they are correctly classified as oil wells, or are improperly maintaining an oil well classification by utilizing liquefied natural gas. Opinion No. 239 does not preclude such state ordered tests. Opinion No. 239 simply orders all respondents, (except J.B. Watkins and Meyer Farms, Inc.) to immediately cease "from selling natural gas from their wells on the acreage subject to this proceeding in the Panhandle West Gas Field in violation of section 7(b) of the Natural Gas Act and [/or] [9]section 504(a) of the Natural Gas Policy Act as set forth in the Recommended Decision issued January 16, 1985."[10] Clearly, only those sales in violation of federal law need to cease; but proper testing for state purposes is encouraged by this Commission and is in no way inconsistent with Opinion No. 239.[11]

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[8]We note that a Travis County, Texas, state court has remanded *Phillips* to the RRC on a procedural issue. However, the court affirmed the substance of the RRC decision and the testing procedures thereunder. Accordingly, the remand is in no way an impediment to our determinations in *Stowers*.

[9]Since some respondents sell their gas in interstate commerce only, the dual conjunctive "and/or" would have been more precise than "and".

[10]Opinion No. 239, 32 FERC ¶ 61,043 at 61,137 (1985).

[11]Objections that the precise volumes that are lawful and unlawful must be delineated specifically by the Commission are groundless. Each operator is able to apply the law to his particular production to determine what gas sales and pricing violates the federal statutes and what does not. This Commission does not consider any production required to comply with reasonable RRC testing requirements to be violative of the federal statutes or of Opinion No. 239, even if the operator has not yet sealed off the dry gas zones. Only the sales diverted from interstate commerce or at

(Footnote continued on next page)

2. *Criteria for Stay*

Stowers argues that a stay is warranted under the four-prong criteria of *Virginia Petroleum Jobbers Association v. FPC.*[12] These criteria are: (1) the likelihood that the party seeking the stay will prevail on the merits; (2) whether irreparable harm will result if a stay is not granted; (3) whether other parties will be harmed if a stay is granted; and (4) how the general public interest will be affected by a stay. We find these criteria have not been met. Therefore, we deny the requests for stay.

(a) *Likelihood of Prevailing on the Merits*

Stowers claims it is likely to prevail on the merits. Citing *Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc.*,[13] Stowers asserts that "the original requirement of 'likelihood of success on the merits' has been considerably relaxed, so that now only a 'substantial case' must be shown."[14] Stowers repeats five basic arguments made even more extensively in its Request for Rehearing to try to demonstrate it has a "substantial case." Specifically, Stowers argues that Opinion No. 239 (1) turns on an incorrect interpretation of state law, (2) intrudes on states' rights, (3) is an *ex post facto* determination of an NGPA gas category, (4) is not supported by any

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(Footnote continued from previous page)
prices in excess of the maximum lawful price have been found to be violative.

[12]259 F.2d 921 (D.C. Cir. 1958). *See* Memorandum in Support of Motion for Stay of Commission Order [sic] No. 239, [Stay Memorandum], filed by Stowers on July 29, 1985, at 3 ff.

[13]559 F.2d 841 (D.C. Cir. 1977).

[14]Stay Memorandum at 3.

evidence, and (5) was issued in a manner that violated due process rights.[15]

Briefly, Opinion No. 239 is based on our interpretation of the NGA and NGPA, federal statutes which are the Commission's sole responsibility to enforce. Not only is Opinion No. 239 consistent with state law, but differing interpretations of local rules "must yield to the interpretation compelled by the policies and legislative goals of the federal statute."[16] Neither the Recommended Decision nor Opinion No. 239 suggest that any *ex post facto* action was taken with regard to the well determinations at issue. Rather, Opinion No. 239 delineates what gas is encompassed by the respective determinations. Extensive and persuasive record evidence supports Opinion No. 239, which adopts the findings of fact, conclusions of law, and application of the facts to law of the Recommended Decision.[17] Finally, sequential notational voting[18] in no way violates the Government in the Sunshine Act, and any assertions of procedural improprieties based on "change of theory" are equally groundless.[19]

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[15]*Id.* at 8-16.

[16]Ecee, Inc. v. FERC, 645 F.2d 339, 356 (5th Cir. 1981).

[17]*See, e.g.*, the arguments in the record and the analysis in Appendix C of the Recommended Decision, which the judge and this Commission found persuasive and convincing. 30 FERC ¶ 63,017 (1985).

[18]*See* Communications Systems, Inc. v. FCC, 595 F.2d 797 (D.C. Cir. 1978).

[19]These arguments are addressed in detail in the section discussing requests for rehearing.

(b) *Asserted Irreparable Harm to Movants*

Stowers asserts that it will experience irreparable harm because "the Commission's order imposes a severe distortion of business and cash flow on the members of the Producer Group,"[20] and if shut-in, the wells may be physically damaged and conservation and competition diminished.

It is not at all clear that the spectre of bankruptcy raised by Stowers even if realistic, is due to the effect of Opinion No. 239, as Stowers claims. Clearly, purchasers have been making payments into escrow accounts for some time *prior* to issuance of Opinion No. 239.[21] Moreover, any money damages that do derive from the opinion and order are insufficient to constitute "irreparable harm," because the courts have interpreted that term to exclude purely monetary harm.[22] As for damage to wells from being shut-in, we have already made clear that Opinion No. 239 does not preclude continued production of oil and gas in conformance with NGA dedication and NGPA pricing requirements, or for testing purposes. Moreover, damage to the rare well that could not lawfully produce any hydrocarbons under Opinion No. 239 is uncertain to occur, and the possibility of such damage is couched in terms of speculation and condition.[23] The applicable

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[20]Stay Memorandum at 19.

[21]*See, e.g.*, Northern Natural's August 13, 1985, Answer at 7.

[22]*See, e.g.*, Wisconsin Gas Co. v. FERC, 758 F.2d 669 at 674 (D.C. Cir. 1985), *citing Virginia Petroleum Jobbers*, 259 F.2d at 925.

[23]*See* Stay Memorandum at 20-23 and Staff's August 13, 1985, Answer at 18.

case law requires that the alleged harm "is certain to occur in the near future."[24]

Stowers' assertions that competition and conservation in the Panhandle Field will be harmed absent a stay are without foundation. Indeed, the present harm to Dorchester's wells and to dedicated reserves far outweighs the speculative harm to Stowers. Opinion No. 239, if anything, encourages *legal* competition in the Panhandle Field. By preventing further violations of the NGA and/or NGPA, Opinion No. 239 eliminates competitive imbalances and untoward practices that flow from the violations of those statutes. As for the assertions regarding conservation, the allegation that the RRC has made an "inherent" finding that the wells drilled by Stowers are "necessary for the efficient drainage of the Panhandle West Gas Field"[25] is incorrect. To our knowledge, such "effective and efficient" findings have not been explicitly made by the RRC as required by our regulations and the NGPA; if made in the future, these findings must be made explicitly, in accordance with the regulations and the NGPA, based on substantial evidence.

(c) *Harm to Other Parties*

The bankruptcy issues raised by Stowers actually militate *against* a stay. A stay would allow continued production and would permit the diversion of low-priced gas dedicated to the interstate market to continue. This would harm both the rightful owners of that gas and the consuming public.

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[24]Wisconsin Gas Co. v. FERC, 758 F.2d 669 at 674 (D.C. Cir. 1985).

[25]Stay Memorandum at 23-24.

Moreover, the harm caused by a stay to Dorchester and Northern is more than just monetary. Northern would be deprived *permanently* of the volumes of dedicated natural gas that would be diverted from the subject acreage by respondents during a stay. It is immaterial whether Northern is taking the gas now or will take it in the future. The harm is the permanent loss of the diverted volumes, and this harm affects both Dorchester as seller and Northern and its customers as purchasers.

(d) *The Public Interest*

Stowers states that the public interest would be served by a stay because a stay (1) would be consistent with the purpose and intent of section 103 of the NGPA, (2) would be consistent with the statutory provisions deferring primary conservation and resource determination to the states, (3) would continue Commission policy of deferring to states for the interpretation of state law, (4) would be consistent with basic concepts of resource conservation by preventing the shutting-in of wells needed to effectively and efficiently drain the field, and (5) would enhance competition.

We have already addressed the conservation and competition issues raised by Stowers. However, we will briefly address Stowers' section 103 contentions. The policies underlying the NGPA and section 103 which limit incentive prices to *new* gas production argue for *denying* a stay. As already noted, Opinion No. 239 does not intrude on purely state areas, but acts in supervening areas of *federal* law which are this Commission's sole responsibility. It is this Commission's Congressional mandate to protect the public interest by preventing diversion of low-cost natural gas from the interstate market in violation of

the NGA and to prevent violations of Title I of the NGPA.

Accordingly, the motions for stay will be denied.

B. *Requests for Rehearing*

The requests for rehearing attempt to reargue positions taken before the presiding judge during the initial hearing and in briefs on exceptions. These may be summarized as follows: (1) The Commission is without jurisdiction, under the NGA and NGPA, to issue Opinion No. 239. (2) The Commission improperly interpreted state law and regulations under the NGA and NGPA. (3) The hearing process and Opinion No. 239 were procedurally flawed. We disagree with each of these specifications of error and deny the requests for rehearing as discussed below.

1. *Jurisdiction*

The Commission has exclusive statutory jurisdiction over the sales and pricing of the dedicated reserves in this proceeding and only the Commission can take enforcement action to assure compliance with the sales and pricing requirement under Federal law. Opinion No. 239 is consistent with the requirements of NGA section l(b) and NGPA sections 601(a) and 503(d).

(a) *NGA section l(b)*

Section l(b) of the NGA provides that the Commission's regulatory authority under the NGA "shall not apply . . . to the production or gathering of natural gas." However, controlling precedent makes clear that the limitation in section l(b) is to be very narrowly construed.[26]

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[26]Unlike the narrow exclusion of section l(b), section 7(b)

(Footnote continued on next page)

In *Phillips Petroleum Co. v. Wisconsin, (Phillips v. Wisconsin)*[27] the Supreme Court made clear that section 1(b) does not deprive the Commission of jurisdiction over the rates charged for sales of dedicated interstate reserves merely because production and gathering are involved. There is a common sense distinction between direct federal regulation of production, and the indirect consideration of production activities that may be relevant to a determination of whether and to what extent Federal law has been violated.[28] The Commission has jurisdiction to determine whether gas which has been dedicated to interstate commerce is being unlawfully diverted and/or illegally priced.[29] As the administrative law judge correctly noted in the Recommended Decision, "dedication" attaches not to an individual sale or producer but to the gas itself.[30] In *Phillips v.*

(Footnote continued from previous page)
of the NGA broadly prohibits the abandonment of any service dedicated to interstate commerce "without the permission and approval of the Commission." 15 U.S.C. § 717(b) and § 717f(b) (1982).

[27]347 U.S. 672 (1954), *reh'g denied*, 348 U.S. 851 (1954).

[28]*See* Colorado Interstate Gas Co. v. FPC, 334 U.S. 581, 602-03 (1945); see *also* Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 at 389 (1959) (Once gas is dedicated to interstate commerce, "there can be no withdrawal of that supply from continued interstate movement without Commission approval").

[29]United Gas Pipe Line v. McCombs, 442 U.S. 529 (1979); California v. Southland Royalty Co., 436 U.S. 519 (1978); Mitchell Energy Corp. v. FERC, 533 F.2d 528 (5th Cir. 1976).

[30]Recommended Decision, 30 FERC ¶ 63,017 at 65,044 (1985), *citing* Hunt v. FPC, 306 F.2d 334, 342 (5th Cir. 1962), *reversed_on_other_grounds*, 376 U.S. 515 (1964); Opinion No. 737, 54 FPC 145, 149 (1975).

Wisconsin the Court concluded that independent producers are "natural gas companies" under the NGA, and their sales in interstate commerce of natural gas for resale are subject to the jurisdiction of, and regulation by, the Commission. This jurisdiction is not exempted by section 1(b), because the "production and gathering" functions end before the sales in interstate commerce begin.

The Supreme Court cases cited by applicants[31] to support their position were decided *prior* to *Phillips v. Wisconsin*. These very cases were alluded to by the Court in *Phillips v. Wisconsin* in 1954 in the process of the Court's *narrowing* of the operation of the NGA section 1(b) exclusion.

As the presiding judge stated in *Stowers*:

> [t]he Commission is not attempting to regulate respondents' production activities but is investigating whether respondents violated and are violating federal statutes. Sections 14, 16 and 20 of the NGA and Sections 501 and 504 of the NGPA authorize Commission action to end violations of the respective statutes . . . . [R]espondents' position . . . would lead to the absurd result that the Commission is powerless to determine whether producers are violating Federal law that Congress

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[31] *See, e.g.*, Motion for Rehearing of the State of Texas at 1, *citing* FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498, 518 (1949) and Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 690 (1947), *reh'g denied*, 332 U.S. 785 (1947).

determined the Commission alone should enforce.[32]

(b) *NGPA section 601(a)*

The respondents argue that even if the limitations of NGA section 1(b) are inapplicable, the Commission's NGA jurisdiction over respondents' gas sales is removed by section 601(a) of the NGPA.[33] We disagree.

Specifically, section 601(a)(l)(B)(iii) of the NGPA provides that the Commission's Natural Gas Act jurisdiction:

> shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to inter state commerce as of the day before the date of enactment of this Act and which is --
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> * * *
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> . . . natural gas produced from any new, onshore production well (as defined in section 103(c) of this Act).[34]

The judge correctly determined that respondents' final section 103 determinations only covered gas from oil proration units, that is, gas indigenous to an oil stratum and produced from that stratum with oil. The judge correctly determined that the sale of gas well gas from these units was not covered by the NGPA section

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[32]Recommended Decision, 30 FERC ¶63,017 at 65,044 (1985).

[33]*See, e.g.* Request for Rehearing of Stowers Oil and Gas Company, *et al.* at 26-28.

[34]15 U.S.C. § 3411(a)(l)(B)(iii) (1982).

503 determinations for pricing under section 103.[35] If their wells produced dedicated gas as well, that gas was not subject to the section 103 determinations because the dedicated gas devolved to Dorchester under the applicable instruments of conveyance as discussed in the Recommended Decision. Accordingly, the arguments on rehearing that this gas was also covered by the section 103 determinations in order to remove the Commission's jurisdiction under section 601(a) is totally without substance. The section 103 determinations simply do not extend to *all* the gas being produced from the respondents' wells. We reaffirm that:

> [t]he evidence shows that most respondents' wells are producing gas which Dorchester would otherwise produce from its existing proration units and *the Railroad Commission has made no finding that respondents' wells are necessary to effectively and efficiently drain that portion of the reservoir from which Dorchester's wells are producing gas.* According to the [sic] NGPA Section 103(c), these respondents are therefore *not* entitled to a

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[35]Applications asserting error because the determination of what constitutes casinghead gas was not made in a rulemaking context are wide of the mark. *See, e.g.* Application of Respondent J. B. Watkins for Rehearing of Opinion No. 239 at 27. The presiding judge applied the plain language of the state's own statutory definition of the term in the course of determining whether NGA and/or NGPA violations were occurring. No *federal* rule or definition of "casinghead gas" was independently adopted such that the APA requirements would apply or a prospective limitation somehow adhere to the determination. The judge merely applied the NGA/NGPA requirements to the respondents. These requirements were applicable during the entire course of the production activities at issue, not only prospectively from the date of the Recommended Decision or Opinion No. 239.

> Section 103 well category determination for gas from the Dorchester proration units. [Emphasis supplied.][36]

We note that the section 103 determination applies to only certain gas consistent with the legislative history surrounding that section.

It is clear from the legislative history that the section 103 price was not intended to apply to gas that could be produced by an existing well. As Senator Hollings stated (concerning what later became section 103 gas), "let us not set up a temptation . . . to start punching holes in existing reservoirs . . . and calling it

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[36]Recommended Decision, 30 FERC ¶ 63,017 at 65,047 (1985). Not withstanding applicants' assertions to the contrary, this Commission's current practice does not recognize that the RRC may make "implicit" findings that a well is necessary to "effectively and efficiently" drain a proration unit. An actual, explicit finding based on substantial evidence is required, whether as part of an RRC Rule 38 exception or otherwise. The only type of acceptable "implicit" finding that a well was needed to effectively and efficiently drain a portion of an existing proration unit would be for *second* wells in a proration unit which are spudded after February 19, 1977, and before January 1, 1979, or for which a drilling permit was issued before January 1, 1979. The Commission permitted such "implicit" findings for wells drilled in existing proration units during that transitional period, because its rules implementing the NGPA were not in place until December 1978. However, only three of the respondent wells were drilled during that period, and the case cited by Stowers, at page 33 of their request for rehearing, *George R. Schurman Norris SUA Baker No. 2 Well*, 8 FERC ¶ 62,098 (1979) is therefore generally inapposite, because the Baker No. 2 well was spudded on December 22, 1978, and was subject to the transitional rule. However, even as to those three wells (Komanche Cobb #2, 3, & 4), it is clear that the RRC made no implicit effective and efficient finding as asserted, because the RRC determinations for these three wells considered them to be the *first* wells in oil proration units.

new gas."[37] Also, Senator Pearson stated, as part of the floor debate, that what was to become section 103 prices should only apply to "natural gas sold from new reservoirs and extensions of existing reservoirs . . . . The economic incentives . . . should only be applicable to truly new gas discoveries."[38]

The fact that Dorchester may have received "effective and efficient" findings for some of its own section 103 wells is irrelevant to the issue of the extent of the gas production covered by respondents' own section 103 determinations. Since respondents operate section 103 *oil* wells, their section 103 determinations only cover gas indigenous to an oil stratum and produced from that stratum with oil. Dedicated dry gas that may be produced from their wells would require an explicit "effective and efficient" drainage finding in order to receive the section 103 price, as opposed to the section 104 price.[39] Moreover, the title to "dry" gas and the proceeds therefrom would need to be resolved in an appropriate forum if produced from respondents' oil wells, even if an explicit "effective and efficient" drainage finding were obtained. Hence, the NGPA section 601(a) jurisdictional exclusion would only apply to authentic casinghead gas that was part of respondents' oil rights, and not to the dry gas dedicated to interstate commerce through Dorchester.

(c) *NGPA section 503(d)*

Various applicants argue that Opinion No. 239 retroactively reverses the respondents' section 103 determinations contrary to NGPA section 503(d). This is a mischaracterization of the Commission' Opinion.

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[37] 121 Cong. Rec. S33589 (daily ed. Oct. 22, 1975).

[38] 123 Cong. Rec. S30373 (daily ed. Sept. 22, 1977).

[39] 18 C.E.R. § 371 305(b)(1) (1985).

The section 103 determinations could not apply to gas that was not part of respondents' oil rights which they did not own. Thus, the section 503(d) procedures, which pertain to review of well category determinations, are not relevant to determining whether the otherwise applicable price ceilings are being exceeded.

Under the broad Congressional implementing authority of NGPA section 501 and NGA section 16,[40] the Commission has the authority *and responsibility* to confirm the limitations of respondents' section 103 classifications to gas that was part of their oil proratic units and produced from below the gas-oil contact in their wells, so as to be indigenous to an oil stratum and produced from that stratum with oil.

There was no reason to reopen the determinations, since they applied to the gas lawfully produced from respondents' wells as casinghead gas. The point is that these determinations were correct -- the gas was section 103 gas insofar as it was true casinghead gas. There was no reason or need to reopen the determinations because the situation *did not warrant* reopening under the regulations.

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[40]Such broad grants of authority have been held "not restricted to procedural minutiae, and [to] . . . authorize means of regulation not spelled out in detail, provided the agency's action conforms with the purposes and policies of Congress and does not contravene any terms of the Act." Mesa Petroleum Co. v. FPC, 441 F.2d 182, 187 (5th Cir. 1971) *citing* Niagara Mowhawk Power Corp. v. FPC, 379 F.2d 158. *See also* Public Service Com'm of State of N.Y. v. FPC, 327 F.2d 893, 897 (D.C. Cir. 1964). (Section 16 of Natural Gas Act held to provide a basis for the Commission to cope with unforeseen problems, and is not confined to procedural regulations, but is a broad grant of authority).

2. *State Law Issues*

(a) *Joint Board*

Various applicants assert that the failure of the Commission to convene a "joint board" with state authorities under NGA section 17 was reversible error.[41] However, Congress clearly intended use of such a board to be discretionary, and even provided that the Commission could, in its sole discretion, revoke any referral to such board: "The Commission *may* refer any matter arising in the administration of this act to a [joint] board . . . . The Commission *may*, when *in its discretion* sufficient reason exists therefor, revoke any reference to such a board." [Emphasis supplied.][42] Another reason convening a joint board was unnecessary is that the section 103 determinations were valid insofar as they applied to respondents' true casinghead gas. Full scale reopenings, and complex and lengthy joint board proceedings simply are not warranted for valid section 103 determinations.

The Commission did, however, seek the advice and counsel of the RRC both in the spirit of comity and in the furtherance of expeditiously dealing with this important matter. The RRC declined participation,[43] but did agree to advise this Commission in writing of related matters before the RRC. We believe this procedure was a reasonable and more efficient alternative to the joint board, which was a discretionary option not needed under the

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[41]*See, e.g.*, Request by Prairie Oil Company, et al. for Rehearing of Opinion No. 239 at 20-21.

[42]15 U.S.C. § 717p(a) (1982).

[43]Letter from Walter Earl Lilie (RRC Special Counsel) to Kenneth F. Plumb (FERC Secretary) (June 11, 1985).

circumstances. Given the immediate need to correct the ongoing violations of the NGA and/or NGPA, and the fact that no reopening of the section 103 determinations was necessary, it was a proper exercise of discretion not to convene a joint board. Assertions that this decision is arbitrary and capricious, or an abuse of discretion are without foundation.[44]

(b) *Abstention*

Applicants generally, and the State of Texas particularly, argue that the Commission should have abstained from acting until Texas had first resolved every tangential state law issue to its satisfaction. Relying, as do other applicants, on cases such as *Burford v. Sun Oil*,[45] Texas argues that it was error for the Commission not to abstain until the various Texas tribunals reached authoritative rulings on issues of state law. However, this Commission believes that the various Texas tribunals *had* reached authoritative rulings on related issues of state law. Even if they had not reached authoritative rulings on all issues, applicants' reliance on *Burford* and related cases is misplaced, and the Commission need not have stayed its hand further, given the circumstances of the *Stowers* proceeding.

The Supreme Court has made it clear that the doctrine of abstention is "the exception, not the rule"

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[44]*See generally* 73A C.J.S. § 247 at 369 ("The ultimate choice of procedure by an agency in making its orders is not ordinarily subject to judicial revision." [footnote and citations omitted]).

[45]319 U.S. 315 (1943).

and "an extraordinary and narrow exception" at that.[46] The Court has indicated that "[t]he abstention doctrine is not an automatic rule applied whenever a federal court is faced with a doubtful issue of state law; it rather involves a discretionary exercise of a court's equity powers."[47]

Applicants' reliance on *Burford* and similar cases is simply misplaced. *Burford*, for example, concerned a state system for review of RRC orders, and the Court held that a federal court that had scant expertise in oil and gas matters should abstain from reviewing the reasonableness of a well spacing order. This is unlike the *Stowers* proceeding, where federal law governs, the federal agency has exclusive jurisdiction, and the expertise to administer the statutes entrusted to it. It is this Commission that has supervening jurisdiction over issues of NGA and/or NGPA compliance, and the Texas regulatory scheme is integral but subordinate to the federal scheme. Accordingly, here *federal* law provides the rule for a decision on the merits, and abstention is not warranted.[48]

(c) *Opinion No. 239 is Consistent with State Law and RRC Rules*

Applicants variously state that it was error for Opinion No. 239 to define "casinghead gas" as it did,

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[46]Colorado Water Conservation District v. U.S., 424 U.S. 800, 813, *reh'g denied*, 426 U.S. 912 (1976) (*quoting* County of Allegheny v. Frank Mashuda Co., 360 U.S. 185, 188-89 (1959).

[47]Baggett v. Bullitt, 377 U.S. 360, 375 (1964).

[48]*See Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* 460 U.S. 1, 23 (1983). (The Court held that where there is substantial doubt that the parallel state proceeding will result in prompt resolution of the issues, it would be an abuse of discretion by the federal forum to stay its hand).

and to use the gas-oil contact to demarcate dedicated gas reserves from undedicated gas reserves.[49] In addition, the RRC states that the presiding judge erroneously refers to the Panhandle Field as a "common reservoir," and states that its recent actions do not support the position taken by this Commission in Opinion No. 239.[50] We disagree with these statements.

(i) *Casinghead Gas*

The presiding judge (and this Commission) utilized the Texas statutory definition of casinghead gas which is also used in the RRC's own statewide rules,[51] namely "any gas and/or vapor indigenous to an oil stratum and produced from the stratum with oil."[52] The gloss that applicants seek to ascribe to that definition is based on generalized statements in annual

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[49]*See, e.g.*, Request for Rehearing of Stowers Oil & Gas Company, *et al.*, at 39-56. Arguments that this Commission has erroneously subdivided strata, or mistakenly divided reservoirs vertically are part of applicants' assertions that the Commission used the wrong definition of casinghead gas in separating dedicated from non-dedicated gas at the gas-oil contact. The essence of *all* these arguments is that this Commission did not properly construe the Texas statutory definition of casinghead gas in demarcating dedicated from non-dedicated gas reserves at the gas-oil contract. Gas from a completion below the gas-oil contact would be indigenous to an oil stratum and produced from the stratum *with* the oil.

[50]*See* RRC Request for Rehearing at 4-7.

[51]Tex. [Nat. Res.] Code Ann. § 86.002(1) (Vernon 1978); Railroad Commission of Texas, Oil & Gas Division, Rules Having State- wide General Application to Oil, Gas and Geothermal Resources Operations Within the State of Texas (Definition 13).

[52]Recommended Decision, 30 FERC ¶ 63,017 at 65,046 (1985).

reports of the RRC and a state attorney general's 1940 letter written regarding circumstances inherently different from those in the *Stowers* proceeding. In the past, when federal courts in the state of Texas[53] and Texas state courts[54] applied the statutory definition, they applied the same definition as written and as applied in Opinion No. 239.

Even if the state statutory definition of casinghead gas were inconsistent with Opinion No. 239 (and it is not), we would not be constrained to use it if its adoption would frustrate implementation of the federal statutes.[55] The presiding judge recognized this fact in stating that the Commission, as a matter of law, would not be bound to apply a state definition "if such definition was unreasonable on its face; or if its adoption would necessarily frustrate implementation of the purpose of the federal statutes[.]"[56]

(ii) *Gas-Oil Contact*

Applicants claim that it was error for the Commission to use the gas-oil contact as the dividing

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[53]Clymore Production Co. v. Thompson, 13 F. Supp. 469 (W.D. Tex. 1936).

[54]Dorchester Gas Producing Co. v. Harlow Corp., *et al.*, Case No. 84-505910, 99th Judicial District, Lubbock County, Texas (Exhibit 616).

[55]*See, e.g., United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 393, 400 (1965). *See also Blair-Vreeland*, 53 FPC 843, 853 (1975), *reversed on other grounds, Vreeland v. FPC*, 528 F.2d 1343 (5th Cir. 1976) ("[W]e cannot give effect to a state law when to do so would interfere with the discharge of our responsibilities under the Natural Gas Act.").

[56]Recommended Decision, 30 FERC ¶ 63,017 at 65,046 (1985).

line between dedicated and non-dedicated reserves. They generally assert that it is a "hypothetical" concept, contrary to state practice, and that it "cannot be determined and enforced consistently." In addition, applicants make vigorous procedural objections to the introduction of the concept.[57]

The state's own rules discuss the "gas-oil" contact so the concept can hardly be termed unexpected or "hypothetical," or contrary to state practice. As the presiding judge noted, the RRC rules provide:

> (B) Isolation of Associated Gas Zones. The position of the gas-oil contact shall be determined by coring, electric log, or testing. The producing string shall be landed and cemented below the gas-oil contact, or set completely through and perforated in the oil-saturated portion of the reservoir below the gas-oil contact. (Statewide Rule 13(b)(4)(B) (Exhibit 531 at 2)).[58]

We believe this lends strong support to Opinion No. 239's approach.

Further, the fact that the gas-oil contact was identified in only one of the subject wells during the proceeding, does not mean that well operators are unable to make that determination directly as provided by the Statewide Rule. It only means that given the exigencies of litigation and discovery, Staff located it "directly" in only one instance (Exhibit 74) but could

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[57]*See, e.g.* Request for Rehearing of Stowers Oil and Gas Company, et al. at 49-56.

[58]Recommended Decision, 30 FERC ¶ 63,017 at 65,028 (1985).

indirectly use secondary evidence to approximate its location for all of respondents' other wells.[59]

Applicants' procedural objections to the use of the concept are that it involved a "change of theory" by Staff, that it is not mentioned in the show cause order, and that the judge should have permitted yet another round of testimony to permit a new witness to testify on the concept. We disagree.

Contrary to these assertions, the show cause order set the inquiry broadly enough to encompass the concept of the gas-oil contact, and in our view, the rebuttal testimony objected to was simply that, *i.e.* rebuttal testimony, and was in no way procedurally improper. The show cause order, for example, contradicts these "change of theory" assertions by alleging that "the brown dolomite stratum is productive only of dry gas at the level at which the operators of each of the [subject] oil wells . . . have perforated or have caused the perforation of such oil wells."[60] This does not imply that the brown dolomite could not produce commercial quantities of oil in a low-lying part of the field. Thus, when Staff rebutted the presence of commercially producible oil in the brown dolomite *in the subject acreage* in part by using the gas-oil contact argument, this did not depart from the show cause order.

In any event, an administrative order initiating a show cause proceeding is not required to be definitive as to every detail that may arise in a later hearing. Although there was no change of theory or departure from the show cause allegations here, even if there had

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[59]Recommended Decision, 30 FERC ¶ 63,017 at 65,048 (1985).

[60]26 FERC ¶ 61,207 at 61,478 (1984).

been to a certain degree, this is permissible where, as here, respondents had adequate general notice of the scope of the proceedings.[61]

(iii) *Texas Railroad Commission*

The Commission reiterates its view that the decisions on LTX units and on "high perforations" reached by the RRC in the *Phillips* proceeding[62] and in the July 8, 1985, public meeting are consistent with Opinion No. 239. While the RRC may not have reached a decision on *all* conceivable issues related to completion practices in the Panhandle Field, the important decisions have been reached. Namely, (1) LTX units may not be used to meet or maintain an oil well classification, and those oil wells that utilized such refrigeration units must be retested, and (2) any oil well reperforated into a dry gas zone must be retested to show the producing capacity and gas-oil ratio, and compliance with applicable rules, orders and statutes.

Having declined our earlier invitation to participate meaningfully in this proceeding, the RRC now claims on rehearing that our decision will have the practical effect of intruding on its regulation of gas and oil completion and production practices in Texas. Specifically, it claims that we have misconstrued the definition of casinghead gas under Texas law because the RRC "has not stated that the existence of perforations above the gas-oil contact in an oil well is in every instance a violation of RRC rules" and has not concluded that "production of gas from above the gas oil contact through perforations below the gas-oil contact

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[61]*See* K. Davis, Administrative Law Treatise § 8.04 (Supp. 1983); 2A Moore's Federal Practice § 8.03 (2d ed. 1984).

[62]RRC Oil and Gas Docket No. 10-77,314.

is improper." (Pet. 5, p.6.) We find this argument unpersuasive.

Contrary to the RRC's claim, our decision does not find that perforations above the gas-oil contact in an oil well violate RRC rules *in every instance*, nor does it reach any broad conclusions about the production of gas from above the gas-oil contact through perforation below the contact. *Stowers* dealt with 37 specific producers and 196 particular oil wells. The subtle points the RRC now raises were simply not the subject of the controversy between the parties. The producers claimed that all gas produced by an oil well was casinghead gas so long as the well met the overall gas/oil ratio for the Texas Panhandle District, and that it was therefore irrelevant whether perforations were made above the gas-oil contact and whether the gas was produced from a stratum that contained no oil in commercial quantities. At the time of the hearing, none of the producers claimed the defense that there had been a shift in the gas-oil contact in any well after their perforations were made or that they were producing gas from above the contact through perforations below the contact issues the RRC now raises as being unsettled. Accordingly, the *Stowers* decision does not address these issues and in no way interferes with the RRC's ability to deal with them.

On the other hand, the RRC's recent pronouncements on high perforations fully support the findings of Judge Murray and the Commission on the general definition of casinghead gas under Texas law and clearly reject the position argued before us by the producers. The *Stowers* decision is thus entirely consistent with Texas law and regulation.

Next, we reject the RRC's argument that we should refrain from construing the definition of casinghead gas under Texas law until the RRC has

finished its review of this question. We have already observed that *Stowers* involves Federal issues over which the Commission has exclusive jurisdiction. We have considered the Texas definition of casinghead gas because it is relevant to the determination of whether or not Federal law has been violated. When the Commission instituted this case, there was no ongoing RRC proceeding on the "high perforations" issue. Indeed, the RRC's own staff has conceded that the RRC had not been enforcing the casing perforation rules in the Panhandle field.[63]

It would be irresponsible for this Commission to allow violations of federal statutes to continue until the RRC finished what promises to be a "lengthy"[64] review to fill in every ancillary detail. The difference between the RRC's rescinded June 10, 1985, memorandum and the RRC's memorandum issued July 8, 1985, regarding "high perforations" is not disagreement over the interpretation of "casinghead gas" or "high perforations" or whether LTX units may be used to maintain an oil well classification; rather, it appears the RRC wants to investigate each individual case to see if an actual violation is occurring.

Finally, the RRC asserts that there was error in the presiding judge's reference to the Panhandle Field as a "common reservoir." A careful reading of the record[65] and the Recommended Decision show that the reference has not been used as a "designation" regarding the physical characteristics of the field, but

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[63]Transcript of the RRC Oil and Gas Conference on July 8, 1985, on the High Perforation Issue, p. 13.

[64]RRC Request for Rehearing at 7.

[65]*See, e.g.*, Tr. 1337-39, Exhibits No. 73 and 265.

that the judge merely noted the language used by the RRC in its 1935 "common reservoir" order.[66]

3. *Procedural Objections*

Applicants' procedural objections generally go either to Opinion No. 239 or to the conduct of the hearing by the presiding judge, and the disposition of interlocutory appeals by the Commission.

(a) *Opinion No. 239*

Applicants assert Opinion No. 239 is not based on substantial evidence and lacks a rational basis, because it adopted the Recommended Decision without extensive further discussion.[67] It is also asserted that the adoption and issuance of Opinion No. 239 violated the Government in the Sunshine Act.[68] As was indicated in the part of this order discussing motions for stay, these allegations are unfounded.

The Recommended Decision was based on extensive and substantial evidence presented in seventeen days of hearings from July 24, 1984, through August 17, 1984. Over 600 exhibits were admitted, and the transcript exceeded 3,800 pages with a total record of approximately 20,000 pages. Testimony was submitted by forty-two witnesses, thirty-four of whom testified on behalf of respondents. In addition, the Commission considered numerous briefs on exceptions

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[66]Exhibit 307.

[67]*See, e.g.*, Application for Rehearing of Cabot Pipeline Corporation at 12-14; Request for Rehearing of Stowers Oil and Gas Company, *et al.* at 67-70.

[68]5 U.S.C. § 552b (1982). Request for Rehearing of Stowers Oil and Gas Company, *et al.* at 79-82.

which essentially restated arguments made at the hearing level. There is nothing that bars the Commission from adopting, without an additional extensive discussion, the analysis of the judge's recommended decision as its own including all findings of fact, conclusions of law, and the application of the facts to the law, as provided by section 8(c) of the Administrative Procedure Act.[69] This is what the Commission did upon issuance of the order in *Stowers*.

Applicants' assertions regarding the Government in the Sunshine Act are not valid, given accepted interpretations of that Act. In *Communications Systems, Inc. v. FCC*,[70] the court rejected a similar argument and held that the legislative history of the Act indicated that Congress intended to allow agencies to act on matters that are circulated among members sequentially in writing. The court specifically held that the agency "was not in violation of the Sunshine Act . . . when it used its notation procedure to dispose of [a] petition."[71]

Finally, brief mention need be made of Prairie Group's assertion that Opinion No. 239 is flawed

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[69] 5 U.S.C. § 557(c) (1982). The Act requires that decisions include a statement of findings and conclusions and the reasons therefor. It is settled law that an agency may adopt a subordinate hearing examiner's statement as its own. *See, e.g.*, Carolina Freight Carriers Corp. v. U.S., 307 F. Supp. 723 (W.D.N.C. Charlotte Division, 1969): "It is now settled law that when the Commission finds no material error in the statement of facts and the conclusions thereon of the Joint Board or hearing examiner, it is not required to prepare a detailed report, but may affirm and adopt the report of such board or examiner as its own." 307 F. Supp. at 727.

[70] 595 F.2d 797 (D.C. Cir. 1978).

[71] *Id.* at 800.

because we allegedly cannot order respondents to cease and desist their unlawful practices. We view Prairies Group's construction of section 16 of the NGA (and similarly section 501 of the NGPA) as too narrow. These types of provisions have not been limited to procedural *minutiae* but are broad grants of authority.[72] Furthermore, we do not anticipate that the Prairie Group or any other respondents will not follow the directives of Opinion No. 239. In any event, Opinion No. 239 also directs Staff to take all necessary action to accomplish the cessation of the NGA and NGPA violations, which would include initiating the type of court proceedings alluded to by the Prairie Group.

(b) *Hearing Process*

Applicants assert numerous instances of what they perceive to be procedural error at the hearing level, in effect alleging that every ruling adverse to them was reversible error. The Prairie Group presents the most complete list of such allegations[73] which includes allegations that the burden of proof was misallocated, that the exclusion of certain proposed testimony was error, that the judge's reliance on other testimony was error, and that not dismissing certain wells from the proceeding was error. We carefully considered the allegations of procedural error and can discern no grounds for reversal.

(i) *Burden of Proof*

The presiding judge spoke respecting the burden of proof as follows:

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[72]*See* n.40 *supra*.

[73]Request by Prairie Oil Company, *et al.* for Rehearing of Opinion No. 239 at 22-38.

> . . . evidence is usually so persuasive in one direction or other that arguments about who has the burden of persuasion are meaningless. In any event, we will save arguments on the ultimate burden of persuasion for briefs.[74]

Recently, we concurred in that statement, noting that the presiding judge may make a ruling on allocating the burden of persuasion, "if the need for such a ruling arises."[75] In this case, the weight of the evidence was that Staff's burden of persuasion was clearly met and there was no error. As the judge noted, the evidentiary presentation of the expert witnesses sponsored by Enforcement Staff and Dorchester was totally persuasive and convincing.[76] We agree.

(ii) *Excluded Testimony*

Applicants counter that the reason evidence was so persuasive is that testimony favorable to respondents was excluded. This allegation is specious. Applicants particularly object that a subpoena was not issued for Mr. W. A. Murray, so that he could give still further testimony after Staff's rebuttal testimony. We believe the judge acted properly in denying the subpoena while allowing testimony from Mr. Murray into the record as an offer of proof. At some point in

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[74]Disposition of Pending Motions, Stowers Oil & Gas Company, *et al.*, issued March 26, 1984, at 3.

[75]Order on Motion for Emergency Relief, Stowers Oil & Gas Company, *et al.*, Docket No. GP84-23-001, issued August 9, 1985. 32 FERC ¶ 61,217 at 61,496.

[76]Recommended Decision, 30 FERC ¶ 63,017 at 65,048 (1985).

litigation, there must be an end to testimony and a closure of the case for decision. Since we find that Staff had not made any abrupt change on rebuttal as alleged, but had merely rebutted respondents' case, denial of the subpoena was proper. The judge fairly entered the testimony into the record as an offer of proof for consideration by the judge and this Commission.

Applicants also object that they were not allowed to depose Mr. Howard Kilchrist, the Commission's Director of the Division of Producer Audits and Pricing. However, applicants were permitted to file interrogatories of Mr. Kilchrist. We continue to believe that this procedure struck a fair balance and permitted respondents to obtain what information they needed, without having the chilling effect on governmental deliberation that the deposition process would have imposed.[77]

(iii) *Credibility of Staff Witnesses*

Applicants attack the credibility of the staff witnesses, especially Mr. Clark Gillespie.[78] During a hearing, the presiding officer is in the best position .to gauge the credibility of witnesses, to observe their demeanor, and to be sensitive to the countless factors that are vital to the hearing process, which are absent from the bare words of the record that is ultimately reviewed. Applicants, who are litigants with vested interests in the outcome, cannot reasonably be permitted to substitute their views on the evidence for those of the impartial trier of fact.

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[77]See 28 FERC ¶ 61,138 (1984).

[78]Request by Prairie Oil Company, et al. for Rehearing of Opinion No. 239 at 31-32.

A careful review of the record indicates that applicants' assertion that staff witness, Mr. Clark Gillespie, had previously testified before the RRC contrary to his testimony in the Stowers proceeding is unfounded.[79]

(iv) *Prairie Group/Lucky Bird/J.B. Watkins Wells*

Prairie Group asserts that twenty-one of its wells should have been dismissed from the proceedings because they were only perforated in the granite wash. However, if such wells are capable of draining Dorchester's dedicated gas, then NGA/NGPA violations have occurred nonetheless. The Recommended Decision (Appendix B) acknowledges that there are some respondent wells not completed in the brown dolomite. However, in discussing these wells, it is pointed out, for example, that "Wy-Vel Coffee No. 1 and Hodges No. 2 [Prairie Group wells] are perforated in granite wash *up to the base of the brown dolomite*,"[80] and Caprock Zack No. 1, Kaari Future Nos. 3 and 1-5, and Raven Snapp No. 4 "are *open to production in the brown dolomite*,"[81] [emphasis added] although listed in Appendix B as "not in" the brown dolomite. Analysis is also provided for the other wells in the group. Accordingly, we are persuaded by the careful analysis in Appendix C that it was not error to keep these, and other Prairie Group wells in the proceedings. To the extent any of the Prairie Group's wells are not in violation of the NGA

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[79]The Reply Brief of Enforcement Staff and Dorchester Gas Producing Company at 114-122 persuasively rebuts these assertions.

[80]Recommended Decision, Appendix C, mimeo at 8-10, 30 FERC ¶ 63,017 at 65,055-57 (1985).

[81]*Id.*, Appendix C, mimeo at 10.

and/or NGPA, gas production may continue to the extent it is casinghead gas.

Lucky Bird also claims that its wells are exceptions and should have been dismissed from the proceedings. However, Lucky Bird's Thornburg leases have gas processing refrigeration units (LTX units) of the type covered by the RRC's *Phillips* decision. Lucky Bird states that it cannot permit RRC tests of its wells under *Phillips* because of Opinion No. 239. As discussed earlier, this conclusion is erroneous. Lucky Bird's wells may be tested by the RRC to determine whether gas currently is being reported as "oil" and thus clarify the issue respecting the Thornburg lease. Given the evidentiary analysis in the Recommended Decision's Appendix C respecting these wells, and the conflicting statements surrounding them, we find no error in not dismissing these wells from the proceedings. Additionally, Dorchester states that Lucky Bird has informed the RRC that its wells do not require testing under the RRC order because they "originally were potentialed without the use of the refrigeration unit."[82] Consequently, Lucky Bird's contention that Opinion No. 239 prevents its wells from being tested, or will cause them to be shut-in is moot.

J.B. Watkins essentially reargues its case with respect to its wells. We believe the judge acted reasonably with respect to Watkins and that the evidence, contrary to Watkins' assertions, was not so "equivocal" as it asserts. It is still "quite possible" as the judge noted, that Watkins is in violation of the federal statutes.[83] The course of action taken, testing of

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[82]*See* Answer of Dorchester Gas Producing Company in Opposition to Supplemental Motion for Stay of Lucky Bird Petroleum, filed August 26, 1985, at 2.

[83]Recommended Decision, 30 FERC ¶ 63,017 at 65,049

(Footnote continued on next page)

Watkin's wells before making a final decision is reasonable under the circumstances, and is neither arbitrary and capricious, nor works to deprive Watkins of due process.

(v) *Other Allegations*

A number of allegations of error are raised, including the failure of the judge to allow certain recross, to allow certain hearsay testimony, to give certain time extensions, and to move the hearing to Amarillo, Texas. We find these objections are without substance. Written pleadings or oral statements responsive to the motions to allow the recross, hearsay testimony, extensions of time, and change of venue to Amarillo are part of the record. We find the judge's rulings on these points to be reasonable.

Prairie Group also states that the Freedom of Information Act (FOIA) required the disclosure of certain documents otherwise privileged. Specifically, the applicants state that FOIA requires disclosure of documents otherwise privileged from discovery under section 522(a)(2)(A) of the Act.[84] Prairie Group states that any pre-decisional document that is "adopted, formally or informally, as the agency position . . ." must be disclosed.[85]

(Footnote continued from previous page)
(1985). On October 9, 1985, the judge's Second Recommended Decision issued, (32 FERC ¶ 63,012), which found Watkins in violation of NGPA section 504, and Meyer Farms in violation of NGA section 7(b) and NGPA section 504.

[84]5 U.S.C. § 552(a)(2)(A) (1984) refers to "final opinions" of an agency and requires them to be made available to the public.

[85]Request by Prairie Oil Company, *et al.* for Rehearing of Opinion No. 239 at 34, *quoting* Coastal States Gas Corp. v. DOE, 617 F.2d 854, 866 (D.C. Cir. 1980).

Contrary to Prairie Group's assertions, the documents sought were neither "final opinions" nor "adopted" by the Commission in any sense of the term. What were sought are documents related to the preliminary investigation of respondents. These documents are covered by a number of privileges including the deliberative process privilege, attorney-client privilege, and work product privilege.

At the time the show cause order was issued, this Commission had neither formally nor informally taken a position regarding possible violations of federal law. The internal privileged documents of attorneys and other Staff which led to the show cause order cannot be deemed to have been "adopted" by the agency as an order. The show cause order fully apprised respondents of the scope of the inquiry regarding them, and set the matter for hearing. That order, Opinion No. 239, and other orders issued in this proceeding have been available to respondents and the public and fully conform to the requirements of the FOIA.

III. *The Commission orders:*

(1) The motions for stay of Opinion No. 239 are denied;

(2) The requests for rehearing of Opinion No. 239 are denied. By the Commission.

(SEAL)

Kenneth F. Plumb,

Secretary.